UNC SCHOOL OF LAW

NORTH CAROLINA LAW REVIEW

Volume 63 | Number 1 Article 7

11-1-1984

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THE QUANDARY OF EXECUTORS WHO ARE ASKED TO PLAN THE ESTATES OF THE DEAD: THE QUALIFIED TERMINABLE INTEREST PROPERTY ELECTION

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Qualified terminable interest property (QTIP) trusts have become extremely popular estate planning devices since Congress authorized them in 1981. If elected by the executor, QTIP status allows an estate to claim the federal estate tax marital deduction for a devise of a life estate to the testator's spouse with the remainder passing to persons of the testator's choosing. Professor Ascher analyzes the fiduciary duty and tax implications of the QTIP election and concludes that the election by itself does not offer the post-mortem estate planning flexibility that previous commentators have claimed. He suggests, however, that, in certain situations, an estate planner can achieve the desired post-mortem flexibility by drafting testamentary provisions for spousal disclaimer along with the QTIP provisions.

The Economic Recovery Tax Act of 1981 (ERTA)[1] reshaped marital deduction estate planning. Planning and drafting for full estate tax deferral at the death of the first spouse to die, made possible by the unlimited marital deduction,[2] have become the norm.[3] The "qualified terminable interest prop-

1. Pub. L. No. 97-34, 95 Stat. 172 (1981) [hereinafter cited as ERTA § —, 95 Stat. —].

2. ERTA § 403(a), 95 Stat. 301 (amending I.R.C. §§ 2056(a), (c)) eliminated all quantitative restrictions on the estate tax marital deduction. *See infra* text accompanying notes 25-31.

3. *See, e.g.*, Adams, *Questions and Answers on the Tax Act of 1981*, TR. & EST., March 1982, at 61, 64-67; Blattmachr & Lustgarten, *Selected Considerations in Structuring Wills (Or Will Substitutes)*, TR. & EST., May 1982, at 37-42 [hereinafter cited as Blattmachr & Lustgarten, *Selected*

erty" (QTIP) trust[4] has replaced the marital-deduction power-of-appointment trust[5] as the most frequently drafted marital deduction trust.[6] To qualify a potential QTIP interest for the estate tax marital deduction, however, the executor must make a QTIP election.[7] This election has been widely acclaimed as a method of achieving post-mortem flexibility.[8] The purported advantages of a full-deferral estate plan, however, have not always been evaluated carefully,[9] and the fiduciary responsibilities that accompany the QTIP election remain virtually unexamined.[10]

Considerations]; Blattmachr & Lustgarten, *The New Estate Tax Marital Deduction: Many Questions and Some Answers*, TR. & EST., Jan. 1982, at 18, 22 [hereinafter cited as Blattmachr & Lustgarten, *Many Questions*]; Blazek & O'Donoghue, *Use of Disclaimers in Post-Mortem Planning*, 40 INST. ON FED. TAX'N ¶ 7.05[1], [2] (1982); Dobris, *Marital Deduction Estate Planning: Variations on a Classic Theme*, 20 SAN DIEGO L. REV. 801, 812 (1983); Eubank, *When the Estate Plan Must be Made Final: An Overview of Decisions and Techniques Shortly after the Decedent's Death*, 17 INST. ON EST. PLAN. ¶¶ 2000, 2001.3 (1983); Hirschon, *Qualified Disclaimers: The Key to Estate Planning Flexibility*, EST., GIFTS & TR. J., Sept.-Oct. 1982, at 4, 8; *see generally* Peckham, *New Estate Planning Techniques for Small and Medium Sized Estates*, 54 N.Y. ST. B.J. 514 (1982).

4. ERTA § 403(d)(1), 95 Stat. 302-03 (codified at I.R.C. § 2056(b)(7)-(8) (1982)) made the marital deduction available for transfers to surviving spouses of certain life income interests for which the deduction previously was not allowable. *See infra* text accompanying notes 11-24.

5. The marital-deduction power-of-appointment trust is described in I.R.C. § 2056(b)(5) (1982). *See infra* note 12 and accompanying text.

6. *See, e.g.*, J. PRICE, CONTEMPORARY ESTATE PLANNING 102 (1983); Dobris, *supra* note 3, at 819 n.155; Farmer, *ERTA '81: Estate and Gift Tax Aspects*, 38 J. OF MO. B. 88, 89 (1982); Keydel, *Estate and Gift Tax Changes Made by the Economic Recovery Tax Act of 1981*, 17 REAL PROP., PROB. & TR. J. 18, 52 (1982); Moore, *Conflicting Interests in Estate Planning and Administration after ERTA: Recognition and Resolution*, 17 INST. ON EST. PLAN. ¶¶ 601, 602.4 (1983) [hereinafter cited as Moore, *Conflicting Interests*]; Moore, *The New Marital Deduction Qualified Terminable Interest Trust: Planning and Drafting Considerations*, 16 INST. ON EST. PLAN. ¶ 900 (1982) [hereinafter cited as Moore, *New Marital Deduction*]; Strauss, *Qualified Terminable Interest Property Offers New Opportunities But Many Problems Are Unresolved*, 9 EST. PLAN. 74, 74-75 (1982).

7. *See* I.R.C. § 2056(b)(7)(B)(i)(III), (B)(v) (1982).

8. *See, e.g.*, Allevato, *The Economic Recovery Tax Act of 1981: Implications of the Estate and Gift Tax Changes Upon Estate Planning*, 11 CAPITAL U.L. REV. 1, 25-26 (1981); Blattmachr & Lustgarten, *Many Questions*, *supra* note 3, at 21; Brackney, *Post-Mortem Planning Is Now Estate Planning*, TR. & EST., Aug. 1982, at 28, 29; Cornfeld, *The Use and Abuse of the Unlimited Marital Deduction*, 16 INST. ON EST. PLAN. ¶¶ 1700, 1702.2 (1982); Covey, *Recent Developments Concerning Estate, Gift and Income Taxation—1981*, 16 INST. ON EST. PLAN. ¶¶ 100, 110.7 to .9, 110.15, (1982); Dobris, *supra* note 3, at 823; Eubank, *supra* note 3, ¶ 2000; Gutierrez, *Fine Tuning the QTIP Election*, 17 INST. ON EST. PLAN. ¶ 1400 (1983); Horn, *Marital Deduction Planning and Drafting After ERTA*, EST., GIFTS & TR. J., Jan.-Feb. 1982, at 23, 24; Joint Report of the Committee on Administration and Distribution of Decedent's Estates and the Committee on Special Problems of Fiduciaries, *The Qualified Terminable Interest Trust Election*, 18 REAL PROP., PROB. & TR. J. 1, 6-8, 17 (1983) [hereinafter cited as Joint Report]; Ketchum & Johnson, *Traditional Simultaneous Death Planning Must Be Reviewed in Light of ERTA, Social Changes*, 10 EST. PLAN. 90, 92 (1983); Keydel, *supra* note 6, at 51-52; Kurtz, *Marital Deduction Estate Planning Under the Economic Recovery Act of 1981: Opportunities Exist, but Watch for the Pitfalls*, 34 RUTGERS L. REV. 591, 605 n.32 (1982); McCaffrey & Kalik, *Qualified Terminable Interest Property*, N.Y.L.J., Oct. 18, 1982, at 1, col. 1, at 2, cols. 3-5; Ordower, *Tax Act Offers New Choices*, TR. & EST., Jan. 1982, at 35, 39; Strauss, *supra* note 6, at 78; Note, *The Marital Deduction Changes in the Economic Recovery Tax Act of 1981*, 13 TEX. TECH. L. REV. 190, 207, 211 (1982).

9. For complete examinations of the economics of full-deferral estate planning, see Eubank, *ERTA: Estate Planning Aspects, New Options and Mental Reconditioning*, 8 PROB. NOTES 47 (1982); Garlock, *Estate Tax Unlimited Marital Deduction Has Limited Advantage in Larger Estates*, 56 J. TAX'N 236 (1982); Harris, *Optimal Use of the Unlimited Estate Tax Marital Deduction*, EST., GIFTS & TR. J., May-June 1982, at 13.

10. The most ambitious effort at identifying and resolving the issues facing the fiduciary who must decide whether to make the QTIP election is the Joint Report, *supra* note 8, which deals,

This Article examines the use of the QTIP election as an estate planning tool. The Article begins with a summary of the changes made by ERTA and their impact on marital deduction estate planning. It also reviews the mechanics of the QTIP election and notes the now-accepted possibility of a partial QTIP election. The Article then offers and evaluates three explanations for the popularity of the full-deferral estate plan that relies on fiduciary exercise of the QTIP election: the benefits of tax deferral, the attractiveness of post-mortem flexibility, and the ease of planning and drafting. Thereafter, the Article examines the extent to which executors asked to make the QTIP election are affected by the fiduciary duty to minimize taxes, the fiduciary duty of impartiality, and the fiduciary duty of loyalty, and describes possible adverse tax implications of estate planning by QTIP election. Finally, the Article offers an alternative to reliance on fiduciary exercise of the QTIP election as a means of achieving post-mortem flexibility.

I. THE IMPACT OF ERTA ON MARITAL DEDUCTION ESTATE PLANNING

A. *Qualified Terminable Interest Property*

The estate tax marital deduction is available only for interspousal transfers of certain types of property interests. Prior to ERTA, three types of transfers qualified for the marital deduction: a transfer of outright ownership;[11] a transfer of property in trust such that all income was payable at least annually to the surviving spouse during her lifetime, and she possessed a general power of appointment over the trust property;[12] and a transfer of property in trust such that the surviving spouse was the only permissible recipient of distributions during her lifetime, and the remainder, including any undistributed income, was payable to her estate.[13] The two trust alternatives thus shared a common element with the outright ownership option—the surviving spouse possessed the means to control the ultimate disposition of the transferred property.

ERTA effected vast changes in the qualitative restrictions on the marital deduction[14] by allowing a deduction for "qualified terminable interest property."[15] The primary characteristic of QTIP is that the surviving spouse must

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however, almost exclusively with the conflict-of-interest problem. *See also* Stewart, *Qualified Terminable Interest Property Election Checklist*, PROB. & PROP., Fall 1982, at 27 (listing factors for fiduciary to consider in making QTIP election decision).

11. *See* I.R.C. § 2056(a), (b)(1) (1982); Treas. Reg. §§ 20.2056(a)-2(b)(4), 20.2056(b)-1(c)(1) (1958).

12. I.R.C. § 2056(b)(5) (1982). This type of trust often is referred to as the "marital-deduction power-of-appointment trust."

13. Treas. Reg. § 20.2056(e)-2(b)(1)(iii) (1958); Rev. Rul. 68-554, 1968-2 C.B. 412; Commissioner v. Estate of Ellis, 252 F.2d 109 (3d Cir. 1958). Because no interest is granted to anyone other than the surviving spouse, the "estate trust" qualifies for the marital deduction. *See* I.R.C. § 2056(b)(1)(A) (1982).

14. *See generally* Schulman, *How and When to Use the New Marital Deduction Qualified Terminable Interest Trust*, 10 TAX'N FOR LAW. 196 (1982).

15. ERTA § 403(d)(1), 95 Stat. 302-03 (codified at I.R.C. § 2056(b)(7) (1982)). For legislative background and analysis of the qualitative changes in the marital deduction made by ERTA, see

be entitled to all of the income at least annually during her lifetime.[16] In addition, no person, including the surviving spouse, can have the power to appoint the QTIP to anyone other than the surviving spouse during the surviving spouse's lifetime.[17] Furthermore, the decedent's executor must elect QTIP status on the decedent's estate tax return.[18] Finally, QTIP is subject to estate tax in the estate of the surviving spouse if not spent, given away, or otherwise dissipated prior to the survivor's death.[19]

QTIP gives married persons unprecedented estate planning freedom. Testators can retain control over the ultimate disposition of their property and still obtain the marital deduction. Although QTIP, therefore, has wide appeal, certain testators find it particularly attractive. Testators with children by a previous spouse are attracted to QTIP[20] because the marital deduction is accompanied by the certainty that these children will be provided for, regardless of the surviving spouse's affections towards them or the existence of children of the surviving spouse.[21] Testators who are concerned that their property not

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generally Note, *The Qualified Terminable Interest Rule: An Overview*, 34 U. FLA. L. REV. 737 (1982).

16. I.R.C. § 2056(b)(7)(B)(ii)(I) (1982).

17. *Id.* § 2056(b)(7)(B)(ii)(II). Powers of appointment exercisable only after the surviving spouse's death do not prevent qualification for the marital deduction. *Id.* § 2056(b)(7)(B)(ii). Thus, the surviving spouse may be granted a testamentary special power of appointment. If the surviving spouse is granted a testamentary general power of appointment, the transfer may automatically qualify for the marital deduction as a marital-deduction power-of-appointment trust. *Id.* § 2056(b)(5).

18. *Id.* § 2056(b)(7)(B)(i)(III), (B)(v).

19. Transfers that qualified for the marital deduction prior to ERTA generally were includible in the gross estate of the surviving spouse, either under I.R.C. § 2033 (1982), as an "interest" in "property," or because of a general power of appointment described in I.R.C. § 2041 (1982). QTIP would not have been includible, because income interests not created by the income beneficiary were not includible in the gross estate. *See* I.R.C. § 2033 (1982); Frazier v. United States, 322 F.2d 221 (5th Cir. 1963). To remedy this disparate treatment, Congress enacted I.R.C. § 2044 (1982) to include QTIP, for which a marital deduction was allowed, in the gross estate of the surviving spouse. ERTA § 403(d)(3)(A)(i), 95 Stat. 303-04. Congress also enacted I.R.C. § 2519 (1982) to subject the QTIP remainder to gift taxation in the event of a lifetime transfer of the surviving spouse's income interest. ERTA § 403(d)(3)(B)(i), 95 Stat. 304.

Because Congress believed that the fairness of including in the gross estate of the surviving spouse property over which she possessed no control and in which she had only an income interest would not be readily apparent to the surviving spouse or the beneficiaries of her estate, ERTA § 403(d)(4)(A), 95 Stat. 304 (codified at I.R.C. § 2207A (1982)), granted the estate of the surviving spouse a right "to recover" from the QTIP recipient the incremental federal estate tax caused by the inclusion of QTIP. *See* H.R. REP. No. 201, 97th Cong., 1st Sess. 160 (1981), *reprinted in* 1981-2 C.B. 352, 378. A gift tax recovery mechanism also was provided. *See* I.R.C. § 2207A(b) (1982).

Unfairness, however, still may be apparent to the beneficiaries of the surviving spouse. State death taxes are not recoverable under I.R.C. § 2207A(b) (1982). No part of the surviving spouse's unified credit applied toward the gift tax on the QTIP remainder is recoverable from the recipients of the QTIP. *See* I.R.C. § 2207A(b) (1982); H.R. REP. No. 201, 97th Cong., 1st Sess. 162 (1981), *reprinted in* 1981-2 C.B. 352, 379. State gift taxes also are not recoverable under I.R.C. § 2207A(b) (1982), which similarly makes no provision for offsetting the permanently increased tax brackets to which the surviving spouse's subsequent gifts will be subject. Finally, the recovery process may prove difficult and expensive.

20. *See* Dobris, *supra* note 3, at 820-21.

21. The testator may fear that his spouse will not treat his children on an equal basis with her children. *See, e.g.*, Johnson, *Some Postmortem Tax and Estate Planning Elections*, ALI-ABA COURSE MATERIALS J., June 1982, at 5, 18; Kahn, *Introduction* (to *Symposium on Selected Topics in Estate and Gift Taxation*), 34 RUTGERS L. REV. vi, vii (preceding 591) (1982).

fall into the hands of successors to their spouses' affections also favor QTIP;[22] they can obtain the marital deduction in a manner which ensures that the surviving spouse will have no power to dispose of the trust principal. In either case the testator nevertheless can ensure the comfort of the surviving spouse through the income interest, the trustee's discretion to distribute principal to the surviving spouse, or the surviving spouse's limited right of withdrawal.

Those who are concerned primarily with the simultaneous maximization of estate tax benefit and minimization of spousal benefit are attracted by the prospect of obtaining the marital deduction in exchange for only an income interest, because the marital deduction is much less expensive. The possibility of granting a special power of appointment exercisable at the death of the surviving spouse[23] promises the additional benefits of flexibility. Not surprisingly, preliminary indications are that the QTIP trust already has replaced the marital-deduction power-of-appointment trust as the most frequently drafted marital-deduction trust.[24]

B. The Unlimited Marital Deduction

ERTA's changes in the marital deduction provisions were not limited to making the marital deduction available for transfers of property that previously did not qualify. It also eliminated the quantitative limitations on the marital deduction.[25] Prior to ERTA, the maximum estate tax marital deduction was the greater of $250,000[26] or one-half of the "adjusted gross estate."[27] Therefore, the marital deduction could eliminate the estate tax completely only in estates of moderate size.[28] Other devices, such as gifts to charity,[29] sometimes were used to obtain a tax-free disposition at the death of the first spouse to die.[30] Because ERTA eliminated all quantitative restrictions on the

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22. *See* Dobris, *supra* note 3, at 820-21.

23. *See supra* note 17.

24. *See supra* note 6.

25. ERTA § 403(a)(1)(A), 95 Stat. 301, amended I.R.C. § 2056(a) (1976), and repealed I.R.C. § 2056(c) (1976), which contained the quantitative limitations on the marital deduction. ERTA § 403(a)(1)(A) also redesignated I.R.C. § 2056(d) (1976) as § 2056(c) (1982).

26. I.R.C. § 2056(c)(1)(A)(i) (1976) (repealed by ERTA § 403(a)(1)(A), 95 Stat. 301).

27. *Id.* § 2056(c)(1)(A)(ii) (repealed by ERTA § 403 (a)(1)(A), 95 Stat. 301). Prior to ERTA, the decedent's debts and the estate administration expenses, deductible under I.R.C. § 2053, and certain losses incurred by the estate, deductible under I.R.C. § 2054, were subtracted from the "gross estate," *see* I.R.C. § 2001 (1982), to arrive at the "adjusted gross estate." I.R.C. § 2056(c)(2)(A) (repealed 1981). I.R.C. § 2056(c)(1)(B) (repealed 1981) further reduced the maximum allowable deduction in cases where the allowed gift-tax marital deduction exceeded 50% of the value of marital gifts. I.R.C. § 2056(c)(1)(C) and (c)(2)(B) (repealed 1981) generally denied the marital deduction for transfers of community property.

28. Prior to ERTA, the marital deduction could shield only estates of $250,000 or less from the estate tax. By 1981 the unified credit equivalent, which equals the amount of property that can pass free of tax by virtue of the applicable unified credit, had risen to $175,625. *See* Tax Reform Act of 1976, Pub. L. No. 94-455, § 2001(a)(2), 90 Stat. 1520, 1846-47 (codified as amended at I.R.C. § 2010 (1982)). Thus, in 1981, by using both the marital deduction and the unified credit, an individual could pass tax-free up to $425,625 to, or for the benefit of, the surviving spouse.

29. The transfers to charities described in I.R.C. § 2055(a)(1)-(4) qualified for the charitable deduction without quantitative limitation. *Cf.* I.R.C. § 2055(d) (1982) (deduction limited to value of property included in gross estate).

30. Typically, the testator's wealth did not permit substantial gifts to charity. Thus, many

marital deduction, any married person, no matter how wealthy, can immunize his estate from the federal estate tax by qualifying his estate for the unlimited marital deduction.[31]

C. *The Increased Unified Credit*

ERTA also increased the unified credit available to offset the tentative estate tax liability.[32] By 1981, the unified credit,[33] introduced by the Tax Reform Act of 1976,[34] had reached its full, phased-in amount of $47,000.[35] ERTA provided a series of further annual increases in the unified credit.[36] If the increases are allowed to become effective as scheduled,[37] the unified credit

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estate planners conceded an estate tax at the death of the first spouse to die. By passing that portion of the estate that did not qualify for the marital deduction in a manner that excluded it from the surviving spouse's gross estate, however, they ensured that this portion would not be subject to tax again at the death of the surviving spouse. Although these assets could be passed to children or grandchildren, they were most often devised in trust for the benefit of either the surviving spouse or the entire family. Such trusts often were referred to as "nonmarital trusts."

31. Many states impose inheritance taxes that provide no or only a small exemption for spousal transfers. In other states, QTIP may not qualify for a marital deduction, or quantitative limitations on the marital deduction may apply. Thus, death taxes remain a possibility in these states, even when use of the unlimited marital deduction eliminates federal estate tax liability. *See generally* Schaeffer, *Avoiding the State Death Tax Disadvantages of the Unlimited Marital Deduction in Large Estates*, 10 EST. PLAN. 36 (1983). For a brief summary of state death taxes, see Covey, *supra* note 8, ¶ 102.1, at 1-382 n.2. For a more detailed analysis of the death taxes of four states, see *Colloquium on Paradigmatic State Inheritance, State Estate and Gift Taxation, and The ERTA*, 34 RUTGERS L. REV. 699 (1982), which analyzes an estate tax (New York), two inheritance taxes (Pennsylvania and New Jersey), and a sponge tax (Florida). For an explanation of a sponge tax, see *infra* note 68. Similarly, federal estate tax may be due on an estate left solely to, or for the benefit of, a surviving spouse. Property used to pay state death taxes or nondeductible administration expenses, for example, does not pass to, or for the benefit of, the surviving spouse. Therefore, it cannot qualify for the marital deduction. When such amounts, together with the decedent's "adjusted taxable gifts," exceed the applicable unified credit equivalent, federal estate tax is generated even though the entire estate seems headed for the surviving spouse. *See* Blattmachr & Lustgarten, *Many Questions*, *supra* note 3, at 18-19; Cornfeld, *supra* note 8, ¶ 1702; Rothenberg, *State Death Taxes Can "Create" Federal Tax Even with Use of Unlimited Marital Deduction*, 10 TAX'N FOR LAW. 346 (1982).

32. *See* ERTA § 401(a)(1), (2), 95 Stat. 299 (amending I.R.C. § 2010 (a), (b)).

33. I.R.C. § 2010 allows a "unified credit" against the "tentative" estate tax liability, which is computed by applying the rate table of I.R.C. § 2001(c) to the sum of the "taxable estate" and "adjusted taxable gifts," and then subtracting the gift tax on the "adjusted taxable gifts." *See* I.R.C. § 2001(b) (1982). The unified credit effectively exempts a certain amount of property passing either during an individual's lifetime or at death.

34. Pub. L. No. 94-455, § 2001(a)(2), 90 Stat. 1520, 1848 (codified as amended at I.R.C. § 2010 (1982)).

35. *See id.* This unified credit was sufficient to shelter a taxable estate of $175,625. *See supra* note 28.

36. The following chart illustrates the phase-in of the unified credit, as scheduled by ERTA.

Year of Decedent's Death	Unified Credit	Unified Credit Equivalent
1982	$62,800	$225,000
1983	79,300	275,000
1984	96,300	325,000
1985	121,800	400,000
1986	155,800	500,000
1987	192,800	600,000

See I.R.C. §§ 2001(c), 2010(a), (b) (1982).

37. The amount of property exempted from tax by ERTA is unprecedented. *See generally* S. SURREY, W. WARREN, P. MCDANIEL & H. GUTMAN, FEDERAL WEALTH TRANSFER TAXATION: CASES AND MATERIALS 1-13 (2d ed. 1982). *But cf.* Zelinsky, *The Estate and Gift Tax Changes of*

will equal $192,800[38] by 1987, enough to shelter taxable wealth of $600,000.[39] Although the increase in the unified credit is not a change in the rules relating to the marital deduction, it has had a major impact on marital-deduction planning.[40]

The marital deduction is primarily an estate tax deferral device.[41] Although it shields property from estate tax at the death of the first spouse to die, the property is subject to estate tax at the death of the surviving spouse unless spent, given away, or otherwise dissipated prior to her death.[42] The unified credit, however, can be used to transfer property in ways that avoid the estate tax at the surviving spouse's death, further postponing the tax.[43] Thus, the "credit-shelter" trust seeks to secure exemption of the largest amount of property from estate tax in both the testator's and surviving spouse's estates through the use of the testator's unified credit.[44] Even if the marital share[45]

1981: A Brief Essay on Historical Perspective, 60 N.C.L. REV. 821, 823 (1982) (arguing that from a "historical perspective" ERTA's changes "do not look like precedent-shattering alterations"). Since ERTA, the increasing federal deficit and the rethinking of estate tax policy have resulted in suggestions that the unified credit be "frozen" at some level below its scheduled fully phased-in level of $192,800. *See* Middleton, *Tax Credit Chill?*, 69 A.B.A. J. 723 (1983); *Freeze of Estate Tax Cuts Proposed*, PROB. & PROP., Summer 1983, at 21. *But see* Treasury News Release of June 27, 1983, [2 Estate & Gift] FED. TAXES (P-H) ¶ 142,183, at 142,249 ("[T]he Administration fully supports Senate Resolution 126, which expresses the sense of the Senate that the estate and gift tax reductions enacted in ERTA should remain undisturbed.").

38. I.R.C. § 2010(a), (b) (1982).

39. *See id.* § 2001(c)(1).

40. *See, e.g.*, Ascher & Kartiganer, *Drafting for the Marital Deduction under the Economic Recovery Tax Act of 1981*, 8 PROB. NOTES 3, 4-6 (1982).

41. *See* J. PRICE, *supra* note 6, at 103; Zelinsky, *supra* note 37, at 825.

42. *See* I.R.C. § 2044 (1982). Actuarial studies indicate that the surviving spouse generally outlives the decedent by eight years. Thomas, Esperti & Katz, *New Variable Marital Deduction Technique Eliminates Uncertainty in Estate Plans*, 47 J. TAX'N 194, 195 (1977); Rosenfeld, *Current Change, Future Shock: Estate Planning in the 1980's*, TR. & EST., Jan. 1982, at 27, 28.

43. Property intended to avoid estate tax at the surviving spouse's death likely will avoid estate taxation for a significant period of time if potentially includible in the gross estate of one in a younger generation. Those most likely to receive an interest subject to estate tax at death are the testator's children, who generally outlive the surviving spouse (their parent) by at least 20 years. If grandchildren receive such interests, the anticipated deferral period is even greater.

44. *See* Adams, Sweet & Herpe, *The Economic Recovery Tax Act of 1981: Big Changes in Store for the Trust Industry*, TR. & EST., Oct. 1981, at 16, 27; Ascher & Kartiganer, *supra* note 40, at 4-6. *See generally* Barnett, *Unexpected (and Often Irrational) Income Tax Consequences of Funding the New Marital Deduction and Credit Shelter Bequests*, 16 INST. ON EST. PLAN. ¶ 1900 (1982); Fruehwald, *Credit Shelter Trusts Should not be Limited to Just the Unified Credit*, 10 EST. PLAN. 200 (1983); Mulligan, *Drafting Marital Deduction Formula Clauses after ERTA to Achieve Maximum Tax Savings*, 57 J. TAX'N 362 (1982); Trapp, *Drafting and Funding Marital and Nonmarital Formula Bequests*, 17 INST. ON EST. PLAN. ¶ 1200 (1983).

The credit-shelter trust's exemption from estate tax at the death of the surviving spouse does not require that the surviving spouse be deprived of the benefit of the property passing to the credit-shelter trust. She frequently is the sole income beneficiary of such a trust, and a trustee power to invade principal for her benefit often is included. Alternatively, the credit-shelter trust can be designed to sprinkle trust income and principal among the surviving spouse and the decedent's children (or others) at the trustee's discretion, frequently with a "five and five" power in the surviving spouse. *See infra*. In either case, the surviving spouse frequently is granted a testamentary special power of appointment. Thus, the surviving spouse is entitled to both beneficial enjoyment of, and significant control over, the entire estate.

A "five and five" power is one designed to fit within the protection of I.R.C. §§ 2041(b)(2) and 2514(e) (1982). It allows the holder to withdraw the greater of $5,000 or 5% of the trust assets each year. Usually, no significant adverse estate or gift tax consequences result from such powers. *But see* Huff, *The "Five and Five" Power and Lapsed Powers of Withdrawal*, 15 INST. ON EST.

passes outright to the surviving spouse, many include credit-shelter trusts in their clients' wills to "save the second tax" at the death of the surviving spouse. This approach increases the family wealth that remains after both spouses die.[46]

D. *A Frequently Recurring Response*

ERTA allows testators to achieve objectives that previously were unattainable. The testator can control the ultimate disposition of his property by using a QTIP trust to qualify for the marital deduction. When a credit-shelter trust is combined with a transfer that qualifies the remainder of the testator's estate for the marital deduction, generally no estate tax will be due at the testator's death. If both spouses utilize such planning, a couple with combined taxable wealth of $1.2 million generally will pay no estate tax. Therefore, a frequent drafting technique is a two-trust estate plan: a credit-shelter trust designed to exhaust the unified credit of the first spouse to die and to avoid inclusion in the gross estate of the surviving spouse; and a residual QTIP trust designed to qualify for the marital deduction and to control the ultimate disposition of the client's property.

II. The Mechanics of the QTIP Election

If a QTIP trust is to qualify for the marital deduction, there must be an "election"[47] "by the executor."[48] Consequently, the election generally will be made by a person subject to fiduciary obligations.[49]

Although the Internal Revenue Code states that the QTIP election is to be made "on the [estate tax] return,"[50] it provides few details. Even though the estate tax return is due nine months after the date of death,[51] the QTIP election probably can be deferred for at least six additional months[52] if a filing extension is obtained.[53] Moreover, the QTIP election should be valid regard-

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PLAN. ¶ 700 (1981) (exploring potential estate, gift, generation-skipping, and income tax consequences of such powers).

45. A "marital" share is that portion of an estate that qualifies for the marital deduction.

46. *See, e.g.*, Allevato, *supra* note 8, at 24-45.

47. I.R.C. § 2056(b)(7)(B)(i)(III) (1982).

48. *Id.* § 2056(b)(7)(B)(v).

49. The term "executor" includes not only executors, administrators, and personal representatives, but also anyone holding property of a decedent if a legal representative has not been appointed. *See* I.R.C. § 2203 (1982). Thus, there may be occasions when the QTIP election is made by one not in a fiduciary capacity.

50. I.R.C. § 2056(b)(7)(B)(v) (1982).

51. *Id.* § 6075(a).

52. *E.g.*, Eubank, *supra* note 3, ¶ 2001.1; Gamble, *New Tax Law May Reduce Estates Subject to Tax by 90%*, TR. & EST., Oct. 1981, at 39, 48 n.20; Gutierrez, *supra* note 8, ¶ 1401.1; Ketchum & Johnson, *supra* note 8, at 92; Keydel, *supra* note 6, at 39; Moore, *New Marital Deduction*, *supra* note 6, ¶¶ 904, 906; Mulligan, *Proposed Regulations Do Not Solve Ambiguities in Planning for Effective Use of Disclaimers*, 10 EST. PLAN. 8, 11 (1983); Strauss, *supra* note 6, at 80.

53. The Secretary of the Treasury is authorized to grant extensions. I.R.C. § 6081(a) (1982). Treas. Reg. § 20.6081-1(a) (1980) delegates that authority to IRS District Directors and the directors of IRS Service Centers. Generally, such extensions may not exceed six months. I.R.C. § 6081(a) (1982).

less when made and regardless whether an extension has been obtained if the election is made on the estate's first estate tax return.[54] The prudent executor, however, will make every effort to exercise the QTIP election on a timely return until the IRS provides formal guidance on this issue.[55]

The Code also specifies that the QTIP election is irrevocable.[56] Thus, important tax consequences to both the estate and its beneficiaries depend upon the exercise of an irrevocable election by one who usually is subject to fiduciary obligations.

Immediately following ERTA's enactment, commentators speculated whether a "partial" QTIP election—one that would qualify only a portion of an interest that could qualify—was possible.[57] The temporary regulations state that partial QTIP elections of certain types are permissible.[58] Under these regulations the election may not be made for specific property but must be made for a "fractional or percentile share."[59] Use of a formula election provision is permitted expressly.[60]

III. UNDERSTANDING THE FULL-DEFERRAL ESTATE PLAN THAT RELIES ON FIDUCIARY EXERCISE OF THE QTIP ELECTION

A. *The Myth of Deferral*

One reason for the popularity of the full-deferral[61] estate plan is the commonly held belief that deferral of estate tax necessarily produces economic advantages derived from the time value of money.[62] Although the surviving

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54. *See* Farmer, *supra* note 6, at 90; Joint Report, *supra* note 8, at 4-5; McCaffrey & Kalik, *supra* note 8, at 2, col. 2.

No legislative history is directly relevant to the timeliness of a QTIP election. The legislative history of ERTA's amendment of I.R.C. § 2032A(d)(1), however, evidences congressional intent to render timely any special use valuation election made on an estate's first estate tax return. *See, e.g.*, CONF. REP. No. 215, 97th Cong., 1st Sess. 249 (1981), *reprinted in* 1981-2 C.B. 481, 508 ("[T]he election is permitted to be made on a late return, if that return is the first estate tax return filed by the estate."). Because ERTA amended § 2032A(d)(1) to describe the special use valuation election in words virtually identical to those used to describe the QTIP election, no timeliness requirement should be imposed on the QTIP election. *Compare* I.R.C. § 2056(b)(7)(B)(v) (1982) ("An election . . . shall be made by the executor on the return of tax imposed by section 2001.") *with id.* § 2032A(d)(1) ("The election . . . shall be made on the return of the tax imposed by section 2001.").

55. *See* Joint Report, *supra* note 8, at 4.

56. I.R.C. § 2056(b)(7)(B)(v) (1982).

57. *See, e.g.*, Adams, *Questions and Answers on the Tax Act of 1981*, TR. & EST., April 1982, at 53, 55-56; Blattmachr & Lustgarten, *Many Questions*, *supra* note 3, at 21; Cornfeld, *supra* note 8, ¶ 1702.2; Moore, *New Marital Deduction*, *supra* note 6, ¶ 905; Strauss, *supra* note 6, at 80; *The Economic Recovery Tax Act of 1981: A Panel Discussion*, 40 INST. ON FED. TAX'N ¶¶ 52.01, 52.04[4] (1982) (remarks of Julian S. Bush) [hereinafter cited as *Panel Discussion*].

58. *See* Temp. Treas. Reg. § 22.2056-1(b), T.D. 7833 (1982).

59. *Id. But cf.* Estate of Alexander, 82 T.C. 34 (1984) (pecuniary amount qualified for marital deduction).

60. *See* Temp. Treas. Reg. § 22.2056-1(b), T.D. 7833 (1982).

61. In this Article, "full deferral" means qualification of the entire estate for the marital deduction, subject only to carving out the unified credit equivalent in such a way as not to be subject to estate taxation at the death of the surviving spouse.

62. *See, e.g.*, Backman & Frank, *Five Factors to Consider in Determining How Much of the Unlimited Marital Deduction to Use*, 9 EST. PLAN. 194, 198, 201 (1982); Blattmachr & Lustgarten,

spouse does realize economic benefits from deferral of the estate tax, deferral, if viewed from the perspective of the QTIP remaindermen, does not necessarily work the same magic.[63]

Full deferral stacks the QTIP of the first spouse to die on top of the taxable estate of the surviving spouse.[64] Thus, full deferral generally ensures that the property on which the estate tax is deferred eventually will be taxed at a higher marginal rate.[65] When the highest applicable marginal estate tax bracket of the estate of the surviving spouse is greater than that of the first spouse to die, more estate tax dollars will be paid at the death of the surviving spouse than the total that would have been paid had a portion of the taxes been paid at the death of the first spouse to die.[66]

Full deferral can cause, from the perspective of the QTIP remaindermen, a further substantial depletion of assets because it deliberately foregoes an opportunity to "freeze" the surviving spouse's estate. At the death of the surviving spouse, the estate tax will be assessed not only on the QTIP, but also on all appreciation and accumulated income.[67] Thus, if the combined estates' assets are likely to increase in value, whether through appreciation or accumulation of income, full deferral can prove especially costly to the QTIP remaindermen.

Many Questions, *supra* note 3, at 21-22, 25 n.24; Covey, *supra* note 8, ¶ 110.15; Koehler, *The Marital Deduction After the Economic Recovery Act of 1981*, in THE PLANNING AND ADMINISTRATION OF A LARGE ESTATE 75, 92-93 (1982); Neufeld, *When to Avoid or Cut Back on the Use of the New Unlimited Marital Deduction*, 10 TAX'N FOR LAW. 132, 135 (1981); Ordower, *supra* note 8, at 35-36, 40-41 n.36; Rodriguez, *Marital Deduction Planning after the Economic Recovery Tax Act of 1981*, 7 REV. OF TAX'N OF INDIVIDUALS 134, 140-42 (1983); Weiss & Etkin, *New Law Overhauls Estate and Gift Taxes, Triggering New Planning Strategies*, 55 J. TAX'N 274, 275-76 & n.19 (1981); Note, *supra* note 8, at 204-06. This explanation of the popularity of full deferral also is noted by Adams, Sweet & Herpe, *supra* note 44, at 28-29; and Kahn, *supra* note 21, at 611-32.

There are, of course, economic benefits available from deferral. Unless some dispersal of the assets occurs prior to the death of the surviving spouse, however, those benefits may accrue only to the surviving spouse; taxes imposed at the death of the surviving spouse can convert economic benefit into a loss. *See, e.g.*, Harris, *supra* note 9.

63. Assume an estate exceeding $2,500,000, subject to the post-1984 50% estate tax bracket. If the first spouse to die qualifies property valued at $1.00 for the marital deduction and the property triples in value prior to the death of the surviving spouse (also in the 50% estate tax bracket), the property remaining after the surviving spouse's death is $1.50. If the first spouse to die chooses not to qualify the property valued at $1.00 for the marital deduction, an estate tax of 50 cents is paid. No additional estate tax, however, need be paid at the death of the surviving spouse. The remaining 50 cents, when similarly tripled, likewise amounts to $1.50 after the surviving spouse's death.

64. *See, e.g.*, Note, *supra* note 8, at 203.

65. Marital deduction property potentially is includible in the surviving spouse's gross estate. *See supra* note 19 and accompanying text. Thus, if the surviving spouse has property of her own, full deferral stacks the property of the first spouse to die in the highest estate tax bracket applicable to the estate of the survivor; it may even push the survivor's estate into a higher bracket. Even if the surviving spouse has no assets of her own, full deferral frequently results in a higher applicable estate tax rate in the survivor's estate than would be the case if approximately one-half of the property had by-passed the survivor's estate. The typical full-deferral estate plan guarantees a significant disparity in the applicable marginal estate tax brackets since the highest applicable estate tax bracket at the death of the first spouse to die is zero percent.

66. *Cf.* Edwards, *Use of Marital Deduction Equalization Clauses: Planning and Caveats*, 39 INST. OF FED. TAX'N ¶ 46.01 (1981) ("In a progressive tax structure, two equal amounts subject to tax will result in the smallest possible tax liability.").

67. For those who believe that a picture is worth a thousand words, Reinders, Boehlje & Harl, *The Marital Deduction: How Much Should You Qualify?*, 1981-82 AGRI. L.J. 262, 263, has a helpful diagram illustrating the concept described in the text.

Assume that a married individual dies in 1987 with a taxable estate (before the marital deduction) of $5,000,000. His spouse dies in 1998 and has no assets of her own. The state death tax applicable to both estates is a sponge tax,[68] neither spouse has made any adjusted taxable gifts, and the value of the assets remains constant. Property not consumed by death taxes at the death of the first spouse to die generates an annual after-tax return of seven percent. The surviving spouse annually consumes $80,000,[69] which is obtained from a marital trust. If the executor of the will of the first spouse to die elects full deferral, no death taxes are paid at the first spouse's death, the credit-shelter trust receives $600,000, and the marital trust receives $4,400,000. If the surviving spouse dies eleven years later, the credit-shelter trust will have grown to $1,262,911, and the marital trust will have grown to $7,998,661. Death taxes at the surviving spouse's death will be $3,582,330, leaving $5,679,242 for the QTIP remaindermen. If the first spouse to die instead had elected to pay the estate tax on one-half of his estate (equalization),[70] the marital trust would

68. A sponge tax is a tax equal to the amount of the federal credit for state death taxes under I.R.C. § 2011 (1982). If the entire estate, other than the unified credit equivalent, qualifies for the marital deduction, the state death tax credit is zero. *See* I.R.C. § 2011(f) (1982). Therefore, the sponge tax also is zero. Since a sponge tax always is equal to the state death tax credit, the total of the federal estate tax and a state sponge tax always is equal to the federal estate tax computed without reference to the state death tax credit. One reason why this analysis must include state death taxes is Congress' failure to coordinate its change in the maximum estate tax rates with the state death tax credit. ERTA § 402, 95 Stat. 300, amended I.R.C. § 2001(c) to decrease the maximum estate tax rate from 70% to 50% during the period 1982 through 1985. I.R.C. § 2011(b) (1982), which also fixes the maximum allowable state death tax credit on a graduated basis, however, was not amended. Thus, after 1984 the highest net federal estate tax bracket for an estate slightly in excess of $600,000 will be 33% (37% less a 4% credit), and that for an estate in excess of $10,000,000 will be 34% (50% less a 16% credit). An estate slightly in excess of $2,500,000, however, will be subject to a federal estate tax bracket of 42% (50% less an 8% credit). Thus, in certain situations, the highest federal estate tax bracket applicable to a very large estate will be lower than that applicable to an estate one-half its size. *See* Clark, *Sweeping Changes in Estate and Gift Taxation Are Part of the New Economic Recovery Tax Act*, 10 TAX'N FOR LAW. 78, 78 (1981); Keydel, *supra* note 6, at 26; *Panel Discussion*, *supra* note 57, ¶ 52.04[2]. To date, Congress, however, has ignored this obvious and embarrassing blunder.

The costs of full deferral often are magnified when state death taxes are considered. In some states there may be no marital deduction or only a small marital deduction. *See supra* note 31. In these states, an estate plan calling for the entire estate to pass to, or for the benefit of, the surviving spouse could trigger a large state death tax liability. If this state death tax liability exceeds the otherwise unused portion of the unified credit equivalent, it also will trigger federal estate tax liability by decreasing the amount qualifying for the federal marital deduction. In any event, in many states the state death tax imposed on the estate of the first spouse to die is likely to exceed significantly the allowable state death tax credit, which, in a full-deferral estate, is zero. *See supra.* The adverse effects of state death taxes often can be reduced by splitting the estates and, therefore, reducing the amount of property subject to the highest marginal state death tax bracket. *See* Garlock, *supra* note 9, at 239-41; Rothenberg, *supra* note 31, at 348-49; Schaeffer, *supra* note 31, at 37-38.

69. In a $5,000,000 estate, the surviving spouse's $80,000 annual consumption may appear unrealistically low. If the facts assumed in the text are modified by allowing the surviving spouse an annual consumption of $200,000, however, equalization, *see infra* note 70, still provides $242,321 more for the QTIP remaindermen than full deferral.

70. In this Article, "equalization" generally means qualification for the marital deduction of that amount necessary to make the taxable estate of the first spouse to die equal to the potential estate of the surviving spouse. In combined estate plans involving less than $1,200,000 per couple, there generally will be no need for equalization after 1986 since the credit-shelter provisions of full deferral usually will be capable of effectuating the tax-free disposition of both spouse's estates. (Two unified credit equivalents of $600,000 will exempt the couple's entire wealth.) Therefore,

receive $2,500,000, and $833,000 in death taxes would be paid immediately, leaving $1,667,000 for the credit-shelter trust. After eleven years the credit-shelter trust would have grown to $3,508,788 and the marital trust to $3,999,442. Death taxes at the surviving spouse's death would be $1,582,721, leaving $5,925,509 for the QTIP remaindermen. Full deferral would cost the QTIP remaindermen $246,267 more than equalization.[71] In fact, regardless

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this Article does not attempt to analyze the benefits of equalization at combined wealth levels of $1,200,000 or less.

In situations when the first spouse to die has a taxable estate (before consideration of the marital deduction) exceeding $5,000,000, the benefits of equalization can be achieved without fully equalizing the couple's estates. After 1984, the 50% maximum federal estate tax bracket will begin at $2,500,000. Prepayment of taxes at a marginal rate equal to that amount at which the taxes ultimately will be imposed is economically unjustified since the same amount of tax depletion occurs regardless when the tax is paid. Prepayment of tax on more than $2,500,000 would forfeit the benefits of deferral during the surviving spouse's lifetime. It would not optimize family wealth and, therefore, never should be used for that purpose. *See* Blattmachr & Lustgarten, *Many Questions, supra* note 3, at 21-22; Dobris, *supra* note 3, at 812 n.87; Halbach, *Reorientation: Tax Deferral under an Unlimited Marital Deduction,* 9 COMMUNITY PROP. J. 42, 43, 45 (1982); Underwood, *Estate Planning after ERTA: O Death, Where Is Thy Sting?,* 2 MISS. COLL. L. REV. 203, 217 (1981).

Prior to 1985, when the maximum federal estate tax bracket gradually is being lowered to 50%, *see* I.R.C. § 2001(c)(2) (1982), it is important that equalization not be used to tax, in the estate of the first spouse to die, more than enough property to reach the 50% estate tax bracket, since the surviving spouse might live beyond 1984 and, therefore, be subject to no greater than a 50% marginal estate tax rate. *See* Backman & Frank, *supra* note 62, at 197.

71. The example in the text is adapted from Kalik, *Economics of the Marital Deduction After ERTA,* in SEVENTH ANN. ARIZ. EST. PLAN. INST. FOR 1982, 248.

The following chart shows the amount of property ultimately available for the QTIP remaindermen upon the death of the surviving spouse when the size of the estate of the first spouse to die varies. The other assumptions made in the text remain unchanged.

Taxable Estate (Prior to Marital Deduction) of First Spouse to Die	Assets Ultimately Available for the QTIP Remaindermen (Full Deferral)	Assets Ultimately Available for the QTIP Remaindermen (Equalization)	Increase in QTIP Remainder Attributable to Equalization
$1,500,000	$1,882,869	$1,777,771	($105,098)
2,000,000	2,501,169	2,533,530	32,361
3,000,000	3,574,390	3,747,242	172,852
4,000,000	4,626,815	4,862,559	235,744
5,000,000	5,679,242	5,925,509	246,267

For other examples that arrive at similar conclusions, see Cornfeld, *Marital Deduction: Planning and Drafting,* 34 MAJOR TAX PLAN. ¶¶ 1400, 1404 (1982) [hereinafter cited as Cornfeld, *Marital Deduction*]; Cornfeld, *supra* note 8, ¶ 1702.3; Garlock, *supra* note 9, at 238; Harris, *supra* note 9, at 15; Keydel, *supra* note 6, at 73 (Exhibit 4); Kurtz, *supra,* note 8, at 606-07; Salus, *The Income Tax Aspects of The Unlimited Marital Deduction,* C.L.U.J., Oct. 1982, at 22, 23-25; Letter of Martin Silfen, *Tax Practitioners' Shop Talk,* 56 J. TAX'N 128 (1982).

The charts and conclusions set forth in Gutierrez, *New Marital Deduction Strategies,* ALI-ABA COURSE MATERIALS J., Oct. 1981, at 15, seem contrary to those presented herein. In fact they are not; Gutierrez makes a very different comparison: full deferral versus no deferral (other than sheltering the unified credit equivalent). Therefore, for very large estates, his charts in essence compare the effect of paying all of the tax at the death of the first spouse with that of paying all of the tax at the death of the surviving spouse.

The conclusions and computations of many commentators also are contrary to those herein. *E.g.,* Backman & Frank, *supra* note 62, at 198-99 & Exhibit IV; Blattmachr & Lustgarten, *Many Questions, supra* note 3, at 25 n.24; Covey, *supra* note 8, ¶ 110.15; Koehler, *supra* note 62, at 99 (Table C); Ordower, *supra* note 8, at 40-41 n.36; Rodriguez, *supra* note 62, at 140-41; Underwood, *supra* note 70, at 216 & n.41; Note, *supra* note 8, at 204-06 & n.84. Such analyses ignore the estate-freezing characteristics of equalization. Instead of adding assumed appreciation or accumulated income to both of the equalized estates and then computing the total amount of property that would have remained after taxes at the death of the surviving spouse, they conclude that comhow great an after-tax return is obtained and how long the period of survival of the surviving spouse, deferral alone cannot provide the QTIP remaindermen any net economic benefit.[72]

By wasting the lowest estate tax brackets of the first spouse to die and subjecting QTIP appreciation and income to taxation at the death of the surviving spouse, full deferral can increase dramatically the total tax burden.[73] Thus, full deferral can deplete substantially the family wealth remaining after the death of the surviving spouse.[74]

B. *The Attractiveness of Post-Mortem Flexibility: How Much Marital Deduction is Appropriate?*

For many clients the cost of full deferral is academic. Understandably, many clients wish to defer taxes until they are unavoidable.[75] Moreover, in many situations the surviving spouse is the overwhelmingly predominant beneficiary,[76] and any estate plan that would increase the assets eventually passing to the QTIP remaindermen at the expense of the surviving spouse is

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pounded earnings from the tax dollars that might be deferred at the death of the first spouse eventually could exceed the amount of taxes that equalization would save if there were no appreciation or accumulated earnings on any estate property other than the deferred tax dollars.

72. *See* Adams, Sweet & Herpe, *supra* note 44, at 28-29; Garlock, *supra* note 9, at 238-39; Harris, *supra* note 9, at 14; Keydel, *supra* note 6, at 39-40.

If the annual after-tax return is significantly greater than 7% and the period of deferral is significantly longer than 11 years, equalization even more dramatically outperforms full deferral. If the facts assumed in the text are varied by assuming an annual after-tax return of 20% and a survival period of 20 years, equalization ultimately provides a staggering $4,485,499 more for the QTIP remaindermen than full deferral.

73. *See supra* notes 71-72 and accompanying text.

74. The analysis offered in notes 71-72 and the accompanying text assumes that not only the property for which the marital deduction is allowed, but also the appreciation and accumulated income, eventually will be taxed at the death of the surviving spouse. Such an assumption has been termed "speculative" and "conjectural" elsewhere. *See* Backman & Frank, *supra* note 62, at 194, 201; Kurtz, *supra* note 8, at 605; Kurtz, *The Impact of the Revenue Act of 1978 and the 1976 Tax Reform Act on Estate Tax Marital Deduction Formulas*, 64 IOWA L. REV. 739, 794 (1979) [hereinafter cited as Kurtz, *Formulas*]. The inappropriateness of equalization in family situations in which depletion rather than augmentation is likely to occur after the death of the first spouse is discussed *infra* notes 119-29 and accompanying text. Equalization, however, is a meaningful concept only at taxable wealth levels exceeding $1,200,000 (after 1986). *See supra* note 70. Even if conservatively invested in tax-exempt municipal bonds yielding 7% per annum, $1,200,000 would yield an annual after-tax return of $84,000, an amount that might exceed the surviving spouse's expenditures. If more aggressively invested, the total return (appreciation and income) from assets in excess of $1,200,000 frequently should exceed the surviving spouse's expenditures. Therefore, in many of the situations in which equalization is feasible, an assumption that the family's wealth will grow during the surviving spouse's life is not speculative. See Garlock, *supra* note 9, at 237-38, which demonstrates that equalization can outperform full deferral in a $10,000,000 estate, even though the surviving spouse withdraws $500,000 per year. See also Cornfeld, *Marital Deduction*, *supra* note 71, ¶ 1404, which demonstrates that with only a 5% after-tax return on a $5,000,000 estate, equalization can outperform full deferral, even though the surviving spouse withdraws $120,000 per year.

75. *See, e.g.*, Cornfeld, *supra* note 8, ¶ 1702.3; Garlock, *supra* note 9, at 239; Halbach, *supra* note 70, at 45; Halbach, *Interspousal Transfers and Ownership after ERTA '81*, 8 PROB. NOTES 122, 128 (1982) [hereinafter cited as Halbach, *Transfers*]; *Panel Discussion*, *supra* note 57, ¶ 52.04[3]; Ruh, *Drafting Marital Deduction Clauses after ERTA*, 11 COLO. LAW. 678, 684 (1982).

76. *See, e.g.*, Polasky, *The Sound and the Furry—Passing the Buck (Thoughts on Passing Property to Spouses and Children)*, 9 INST. ON EST. PLAN. ¶¶ 2000, 2003.1 (1975).

inappropriate. Another reason for full deferral's popularity must therefore exist.

When a client's estate plans are formulated, no one can predict with certainty many of the factors on which the decision to defer the estate tax must be based.[77] Thus, it is arguable that a lawyer should attempt to preserve the no-tax option. The need for a subsequent reevaluation of that decision, however, is implicit in such a decision. Periodic reviews of clients' dispositive documents is one way to perform this reevaluation. Unfortunately, many of the uncertainties that make full deferral a popular drafting technique disappear, if at all, only after the client has died. Thus, many draftsmen rely, instead, on the QTIP election to secure subsequent reevaluation of the full-deferral decision at the time they believe it is most needed—after the client's death.[78] Because the temporary regulations allow partial QTIP elections,[79] they have been hailed as the "go ahead" for using the QTIP election to "fine tune" an estate plan after the client's death.[80] The decision on the appropriate amount of the marital deduction is thus deferred until more of the facts necessary to make an informed decision are known.

The validity of using the QTIP election to plan the estates of the dead depends on the proposition that the executor will be in a better position to answer the question, "How much marital deduction is appropriate?," than the client. To test that proposition, the considerations that assist in answering the question must be analyzed.[81]

1. Simultaneous or Nearly Simultaneous Deaths of the Spouses

Full deferral is inappropriate when spouses die simultaneously or nearly simultaneously.[82] Because there is not time for the benefits of full deferral to

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77. *See, e.g.*, Kurtz, *Formulas*, *supra* note 74, at 776.

78. *See supra* note 8.

79. Temp. Treas. Reg. § 22.2056-1(b), T.D. 7833 (1982).

80. *See, e.g.*, Eubank, *supra* note 3; Gutierrez, *supra* note 8; McCaffrey & Kalik, *supra* note 8, at 2, cols. 3-5.

81. The order that the factors are discussed in the text represents the author's judgment regarding their relative conclusiveness in making the full deferral/equalization decision. For example, if the testator agrees strongly that his spouse is his overwhelmingly predominant beneficiary, the author believes that, other than in planning for the simultaneous or nearly simultaneous deaths of the spouses, full deferral generally will be appropriate, regardless of any other factor. Accordingly, the inquiry as to the surviving spouse's position in the client's dispositional hierarchy is discussed second, *infra* text accompanying notes 96-104, following only the discussion of planning for simultaneous or nearly simultaneous deaths, *infra* text accompanying notes 82-95. Various lower-level factors may, and often will, point in opposite directions. For example, if it appears that the couple's combined taxable wealth will increase dramatically during the surviving spouse's lifetime, equalization is indicated. *See infra* text accompanying notes 117-21. But if the testator trusts his surviving spouse to undertake a faithful program of giving to the testator's QTIP remaindermen, full deferral is indicated. *See infra* text accompanying notes 122-29. Rethinking thus may reveal that the couple's combined taxable wealth is likely to decrease, and therefore no conflict exists. In other situations, actual conflicts will exist. The author suspects that these decisions often will be made on the basis of factors that the testator is most firmly committed to, that the testator and his attorney believe they have made the most accurate estimates of, or that appear highest on the list in the text.

82. Even full deferral advocates agree with this proposition. *See, e.g.*, Kurtz, *supra* note 8, at 605 n.32; Note, *supra* note 8, at 206.

be realized,[83] full deferral provides few advantages to the surviving spouse.[84] Thus, if the sum of either spouse's taxable estate and adjusted taxable gifts, in addition to the property that full deferral would confer, reasonably can be expected to exceed the unified credit equivalent, provision must be made for a more appropriate response should the spouses die simultaneously or nearly so.[85] The best way to anticipate this possibility is to include an equalization clause in the dispositive document of the "wealthier" spouse that would equalize the spouses' estates' highest applicable estate tax brackets[86] if the "poorer" spouse died within six months of the wealthier spouse.[87] The poorer spouse's dispositive document, either expressly or by the effect of a similar equalization clause, would not benefit the wealthier spouse if the wealthier spouse died within six months of the poorer spouse. This automatically would optimize the property passing to the QTIP remaindermen.[88]

Some commentators contend that the QTIP election and disclaimers by

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83. *See* Kurtz, *Formulas, supra* note 74, at 795.

84. *See* Dobris, *supra* note 3, at 828-29 n.232.

85. *See id.* at 828. *Cf.* Edwards, *supra* note 66, ¶ 46.05 (pre-ERTA recommendations for nearly simultaneous deaths).

86. *See* 4 A. CASNER, ESTATE PLANNING 1377 (4th ed. 1980); J. PRICE, *supra* note 6, at 265-67. For a concise discussion of equalization clauses, see Edwards, *supra* note 66. Many changes, however, have occurred since Edwards' article. When he wrote, the quantitative limitations, which generally limited the marital deduction to 50% of the adjusted gross estate, *see supra* text accompanying notes 26-27, served to equalize spouses' estates whenever one spouse owned most of the property. Thus, when formula clauses were used, overfunding the marital deduction trust generally was only a possibility if both spouses had substantial amounts of property. *See* Ordower, *supra* note 8, at 35; Rodriguez, *supra* note 62, at 136-39; Comment, *Equalization Clauses with Alternate Valuation: An Emerging Option for Estate Planners,* 63 IOWA L. REV. 486, 490 (1977). ERTA opened the door to unlimited marital deduction estate planning and increased the likelihood that the marital deduction would be overfunded in cases when the property of the first spouse to die exceeded twice the applicable unified credit equivalent. (Two unified credits are available: one for each spouse's estate.) This dramatically increased the risk of overfunding.

At the time that Edwards wrote, the principal reason for not using equalization clauses was the Service's opposition to their use. The Service's position was that the surviving spouse's interest in property passing under an equalization clause was a nondeductible terminable interest. *See IRS Explains Why Equalization Clause Bars Marital Deduction, Tax Practitioner's Shop Talk,* 42 J. TAX'N 254 (1975) (reproducing large portions of what appears to be an early I.R.S. Technical Advice Memorandum). All three cases that had considered this position, however, were decided against the IRS. *See* Estate of Meeske, 72 T.C. 73 (1979); Estate of Smith, 66 T.C. 415 (1976), *aff'd per curiam,* 565 F.2d 455 (7th Cir. 1977); Estate of Laurin, 38 T.C.M. (CCH) 644 (1979). Because the IRS had issued a nonacquiescence in *Smith,* 1978-1 C.B. 3, however, the threat of loss of the marital deduction was real. Since then, in Estate of Laurin v. Commissioner, 645 F.2d 8 (6th Cir. 1981), the United States Court of Appeals for the Sixth Circuit has affirmed both *Laurin* and *Meeske,* and the IRS has acquiesced in *Laurin, Meeske,* and *Smith,* 1982-1 C.B. 3. Thus, the threat has disappeared.

87. I.R.C. § 2056(b)(3) (1982) allows a marital deduction transfer to be conditioned upon spousal survival for up to six months. For examples of provisions requiring equalization if the surviving spouse fails to survive the first spouse to die by at least six months, see Cornfeld, *Marital Deduction, supra* note 71, ¶ 1409, Forms 6, 7, and 10. Similar provisions in Backman & Frank, *supra* note 62, at 197, contain an equalization mechanism that automatically adjusts to the decreasing maximum marginal estate tax rates during the period 1982-85. Until 1985 such a self-adjusting mechanism is important. After 1984 the highest marginal estate tax bracket will be fixed at 50%. *See* I.R.C. § 2001(c) (1982). If the first spouse to die was to die in 1984 and the surviving spouse was to die in 1985, but within six months of the death of the first spouse, a straightforward equalization clause might be construed to require prepayment of the estate tax at a higher rate in the estate of the first spouse to die than would be possible in that of the surviving spouse. *See generally supra* note 70.

88. If the spouses' dispositive documents do not provide for the same beneficiaries or do so in

the executor of the "surviving" spouse are preferable techniques for resolving simultaneous death cases[89] since such mechanisms provide flexibility if the surviving spouse's death occurs more than six months after the death of the first spouse to die.[90] Drafting for equalization, however, does not foreclose utilization of these methods. It merely ensures that equalization will occur when appropriate. Drafting for equalization, therefore, does not diminish the purported attractiveness of the QTIP election or the executor disclaimer. To the extent that these techniques work at all, they can be used to reduce the surviving spouse's share if she dies more than six months after the death of the first spouse to die.

Another argument favoring reliance on the QTIP election or executor disclaimer is that availability of the credit for property previously taxed[91] may represent a more desirable tax option than equalization.[92] Planning for use of this credit, however, requires that a tax be imposed on both estates.[93] Since equalization ensures that a tax will be imposed on both estates, it is a step in the right direction.[94] Furthermore, it does not foreclose additional fine-tuning using a partial QTIP election or disclaimers by the executor of the "surviving" spouse.[95]

Full deferral usually is totally inappropriate in the case of the simultaneous or nearly simultaneous deaths of spouses. Because an equalization clause automatically approximates the optimal tax result in these cases, reliance on

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different amounts or terms, equalization might be inappropriate. Unless QTIP is used, equalization might deflect a portion of the wealthier spouse's estate to the poorer spouse's beneficiaries.

89. *E.g.*, Covey, *Recent Developments Concerning Estate, Gift and Income Taxation—1982*, 17 INST. ON EST. PLAN. ¶¶ 100, 130.7 (1983); Covey, *supra* note 8, ¶ 110.9; Ketchum & Johnson, *supra* note 8, at 92-94; Le Van, *Simultaneous Death after ERTA*, 17 INST. ON EST. PLAN. ¶¶ 1800, 1821-22, 1823(11)(D) (1983).

90. *Compare* I.R.C. § 2056(b)(3) (1982) (six months for marital transfers conditioned upon survival) *with supra* notes 51-55 and accompanying text (apparently no time limit for the QTIP election) *and* I.R.C. § 2518(b)(2) (1982) (nine months for qualified disclaimers).

91. An estate tax credit is allowable for certain property recently subjected to estate tax in another's estate. *See* I.R.C. § 2013 (1982). This credit is available for an income interest, even though the interest is not includible in the gross estate of the second decedent. *See* Treas. Reg. § 20.2013-5(a) (1973); Rev. Rul. 59-9, 1959-1 C.B. 232 (estates of lifetime income beneficiaries qualify for credit).

92. *E.g.*, Covey, *supra* note 8, ¶ 110.9; Ketchum & Johnson, *supra* note 8, at 92. In the case of nearly simultaneous deaths, minimizing the marital deduction may generate a substantial I.R.C. § 2013 credit, because the surviving spouse is always the income beneficiary of the QTIP trust. This credit then reduces the surviving spouse's estate tax. *See* Moore, *New Marital Deduction*, *supra* note 6, ¶ 904. The § 2013 credit, however, has been held to be unavailable in a case involving simultaneous deaths. Estate of Lion, 52 T.C. 601 (1969), *aff'd*, 438 F.2d 56 (4th Cir.), *cert. denied*, 404 U.S. 870 (1971).

93. *See* I.R.C. § 2013(a)-(c) (1982).

94. *Cf.* Adams, *Questions and Answers on the Tax Act of 1981*, TR. & EST., July 1983, at 53, 54 (providing an example where use of the § 2013 credit was slightly superior to equalization but that required less (not more) marital deduction than equalization provided).

95. The possibility that a partial QTIP election or a disclaimer could approximate equalization and thus salvage a full-deferral primary estate plan, *see supra* notes 89-94 and accompanying text, is no excuse for failing to ensure, by drafting, an appropriate result. *See* Schaeffer, *supra* note 31, at 40; Trapp, *supra* note 44, ¶ 1200.3. Unfortunately, mistake and delay occur even in the best of law firms. When attorneys with little estate planning experience or lay executors undertake to probate wills, mistake and delay are probable.

fiduciary exercise of the QTIP election offers at most only incremental advantages.

2. Surviving Spouse is Overwhelmingly Predominant Beneficiary

The surviving spouse frequently is the testator's overwhelmingly predominant beneficiary.[96] This is true if the testator desires that the surviving spouse have every economic opportunity that the testator's money can provide. It is also true if the testator desires that the largest amount possible be available to the surviving spouse as a safety net against ill health, unexpected longevity, or adverse economic forces.[97] Because full deferral eliminates estate tax depletion at the testator's death,[98] it is appropriate if these objectives are the testator's primary concern.

The propriety of full deferral when the surviving spouse is the testator's overwhelmingly predominant beneficiary is evidenced not only by the fact that equalization's prepayment depletes funds that generate the surviving spouse's income, but also by the fact that the surviving spouse almost certainly will have some access to principal. The testator may grant the marital bequest outright, or, if the marital bequest is in a marital-deduction power-of-appointment trust or QTIP trust, he may grant the surviving spouse a lifetime right of withdrawal. Alternatively, the testator may authorize the trustee to invade principal for the benefit of the surviving spouse. Consequently, prepayment of estate tax reduces the amount of principal available for the surviving spouse's needs, as well as her income stream.

The surviving spouse, however, may not be the testator's overwhelmingly predominant beneficiary. In an unsuccessful marriage, the testator's desire to provide his surviving spouse with a substantial interest in his estate may be consistent with a primary desire to optimize the QTIP remainder.[99] Thus, drafting for equalization (or some step in that direction) as the primary estate plan may be more appropriate than drafting for full deferral.[100] In other situations—those involving multiple marriages—the surviving spouse must share with others not only the testator's affections, but also the testator's bounty.[101] Drafting for full deferral probably is inappropriate in these circumstances, even if intended only as a starting point for post-mortem planning designed to reduce the marital deduction.[102] Instead, optimization of the QTIP remainder

96. *See supra* note 76.

97. The testator's desire to ensure against the adverse effects of inflation is such an example. *See* Backman & Frank, *supra* note 62, at 194, 197.

98. *See* Joint Report, *supra* note 8, at 14-15.

99. *See generally* Kramer, *Estate Planning for the Stable and Not-So-Stable Marriage and Nonmarital Cohabitation*, 39 INST. ON FED. TAX'N ¶¶ 56.01, 56.03 (1981) (a pre-ERTA account of income, gift, and estate tax considerations in premarital, marital, and postmarital estate planning, supplemented by overviews of state-law property rights of spouses and cohabitants).

100. *See* Blattmachr & Lustgarten, *Selected Considerations*, *supra* note 3, at 21 (full deferral may not be appropriate, even as a primary estate plan).

101. *See* Polasky, *supra* note 76, ¶ 2003.7 (suggesting, even prior to ERTA, use of maximum marital deduction might be inappropriate "where it is desirable to provide for children of a prior marriage").

102. Intentionally "overfunding" the marital share requires an effective means of reducing the

may be the testator's foremost objective. Thus, a primary estate plan aimed at or amounting to equalization would be appropriate.[103] Similarly, the testator may want his children to receive a substantial benefit immediately upon his death.[104] If the children are required to wait until the death of the surviving spouse, they could predecease the surviving spouse, and, therefore, never benefit from the marital share. This possibility is particularly likely (and potentially disastrous) if the surviving spouse is not the parent of the testator's children and is significantly younger than the testator.

The question, "Is my spouse my overwhelmingly predominant beneficiary?" cannot be answered better after the testator's death; only the testator can answer it. Reliance on the executor to make the QTIP election, however, requires the executor to answer it.

3. Charitable Remaindermen

If the QTIP remaindermen are charities, full marital deferral is appropriate unless the testator desires to benefit charities immediately upon his death. Since the entire QTIP remainder will qualify for the charitable deduction in the surviving spouse's estate,[105] the testator can benefit his spouse without fear of affecting the overall estate tax consequences at her death.[106] Thus, there is no estate tax borne by the charitable QTIP remaindermen. Since the testator who creates a charitable QTIP remainder almost certainly does not envision any situation in which it would be appropriate for his executor to prepay the estate tax, fiduciary discretion to make the QTIP election adds only the possibility of confusion.

4. Possible Changes in the Estate Tax Law

Prepayment of a tax assumes that the tax ultimately will be required. Thus, if the tax ultimately will not be required, it makes no sense to prepay the tax. Similarly, if a tax is prepaid to make the ultimate tax less burdensome, a subsequent reduction of that tax probably will render the amount prepaid ex-

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marital deduction after the testator's death. *See supra* text accompanying notes 77-81. For reasons developed at length, *infra* notes 144-293 and accompanying text, fiduciary exercise of the QTIP election may not be a reliable means to accomplish that goal. Furthermore, reliance upon a spousal disclaimer in the situation described in the text would be foolhardy.

103. When the testator desires an immediate bequest of more than $600,000 to, or for the benefit of, his children, full deferral is impossible since post-1986 full deferral will require that the children receive a maximum of $600,000 prior to the surviving spouse's death.

104. *See* Cornfeld, *supra* note 8, ¶¶ 1700, 1702.2.

105. The Technical Corrections Act of 1982, Pub. L. No. 97-448, § 104(a)(1)(B), 96 Stat. 2380 (codified at I.R.C. § 2044(c) (1982)) eliminated any doubt whether the remainder to charity would qualify as having "passed from" the surviving spouse to charity for purposes of the charitable deduction under I.R.C. § 2055 (1982). *See* S. REP. No. 592, 97th Cong., 2d Sess., 20, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 4149, 4166.

106. *But cf.* Letter of Richard A. Williams, in *Tax Practitioners' Shop Talk*, 59 J. TAX'N 287 (1983) (fear that charitable deduction might not be available to estate of surviving spouse in Arkansas, because, under Arkansas law, surviving spouse's estate tax liability, which might arise on account of surviving spouse's own assets, could be apportioned to the charitable QTIP remainder).

cessive.[107] Therefore, if the testator believes that there is a significant possibility that the transfer taxes will be repealed or reduced between his death and the death of his spouse, full deferral is indicated.[108]

Speculation concerning the future of the transfer tax system, however, is extremely perilous. Some commentators suspect that the federal transfer taxes currently are at the end of a pendulum swing.[109] If so, a probability exists that the federal transfer taxes will become more burdensome.[110] In any event, the possibility of repeal or amelioration of the federal transfer taxes argues against equalization only if the predicted repeal or amelioration is likely to occur during the period of survival of the testator's spouse. One who would make such a prediction is indeed self-confident. Although such a self-confident client's opinion indicates full deferral, his opinion is, nevertheless, available only during his lifetime.

Fiduciary exercise of the QTIP election contributes only the possibility of a later glimpse at congressional attitudes toward the estate tax law. Although such a glimpse should aid the executor in formulating an opinion on the likelihood of imminent changes in the estate tax laws, only an extraordinarily rare and risk-oriented executor would be willing to base his QTIP election decision on such an opinion.

The risk-averse client, although not professing knowledge about the future direction of the estate tax laws, may refuse to accept even the slightest risk that the tax will be repealed during the period of survival of his spouse. In such a case, full deferral is the only answer. Discretion in the executor to make the QTIP election is superfluous.

5. Liquidity

The estate of the first spouse to die may be highly illiquid, depending on the nature of its assets and the extent of its obligations. Liquidity, in fact, may be one of the estate planner's primary worries if the principal asset is a closely-held business, a farm, or a parcel of unimproved real estate. Full deferral offers relief from one of the major sources of illiquidity, the federal estate tax.[111] Consequently, liquidity is another consideration supporting full deferral.

Eliminating tax-based liquidity concerns through full deferral, however, may only sweep them under the carpet. At the death of the surviving spouse the tax-based liquidity problem may resurface in a more acute state.[112] There-

107. *Cf. supra* notes 70 & 87 (discussing equalization during the phase-in of the 50% maximum transfer tax bracket).

108. *See* Cornfeld, *supra* note 8, ¶ 1702.2. *Cf.* A CASNER, ESTATE PLANNING 745-46 (4th ed. Supp. 1982).

109. *E.g.*, S. SURREY, W. WARREN, P. MCDANIEL, & H. GUTMAN, *supra* note 37, at xvii-xviii, 12-23; Zelinsky, *supra* note 37, at 829 ("ebb and flow").

110. *But see* Graetz, *To Praise the Estate Tax, Not to Bury It*, 93 YALE L.J. 259, 285-86 (1983) (predicting and lamenting demise of estate tax).

111. *See, e.g.*, Note, *supra* note 8, at 204.

112. *See* Cornfeld, *supra* note 8, ¶ 1702.2; Cornfeld, *Marital Deduction*, *supra* note 71, ¶ 1402.

fore, if the long-term preservation of a family business or farm is a primary goal of the testator, full deferral should be undertaken only if the deferred liquidity concerns can be resolved prior to the death of the surviving spouse or if the testator is willing to run the risk that they will not be addressed.[113]

Determining the importance of liquidity in marital deduction estate planning thus requires an answer to another question: "Does the testator want the family business eventually to pass intact to the QTIP remaindermen?" Although the importance of liquidity may be diminished by the estate's ability—which the executor may be able better to assess—to qualify for the various relief provisions of the Internal Revenue Code,[114] only the testator can answer the crucial, underlying question.

6. Facts Peculiar to the Surviving Spouse

Even if the surviving spouse is either very old or terminally ill, she may outlive the periods during which the marital deduction can be terminated automatically, nonelected, or disclaimed.[115] It may, nevertheless, be clear that the surviving spouse will not live long enough to be harmed significantly by prepayment of a portion of the estate tax. Similarly, the surviving spouse may be so wealthy that no prepayment of estate tax at the death of the first spouse to die is likely to affect her life style. Thus, both situations call for optimization of the QTIP remainder and suggest equalization as the primary estate plan.[116] In almost all cases, however, the old age, terminal illness, or great wealth of the spouse will be apparent to the client. Reliance on fiduciary exercise of the QTIP election, therefore, accomplishes little that the client cannot do during his lifetime. Fiduciary exercise of the QTIP election only offers the possibility of a reduced marital deduction if the surviving spouse becomes terminally ill or very wealthy shortly after the death of the first spouse to die.

7. The Couple's Likely Combined Taxable Wealth

Equalization generally is appropriate only in the largest estates. If the sum of both spouses' taxable estates, added to the sum of both spouses' adjusted taxable gifts, is unlikely to exceed the sum of the unified credit equivalents available at the spouses' deaths, full deferral usually will avoid imposition of any estate tax.[117] After 1986, therefore, equalization rarely will be appropriate at combined taxable wealth levels below $1,200,000.[118]

113. One way to provide for liquidity at the death of the surviving spouse is to obtain insurance on her life.

114. *E.g.*, I.R.C. §§ 303, 2032A, 6166 (1982).

115. *See supra* note 90.

116. *Cf.* Joint Report, *supra* note 8, at 14 (suggesting nonelection of QTIP status in such cases).

117. *See* I.R.C. §§ 2001(b)-(c), 2010(a)-(b) (1982).

118. *See supra* note 70.

(a) Predictions whether the couple's combined taxable wealth will increase or decrease

Even if a couple's likely combined taxable wealth exceeds the estimated sum of their unified credit equivalents, equalization is not always economically appropriate.[119] Much of equalization's attractiveness derives from its ability to freeze the estate of the surviving spouse.[120] Consequently, equalization loses much of its appeal if the surviving spouse, either through consumption or by gifts, or the trustees, through invasions of the credit-shelter trust in favor of beneficiaries other than the surviving spouse, are likely to deplete the couple's combined taxable wealth at approximately the same rate that income and appreciation are likely to augment it. If depletion is likely to exceed augmentation substantially, as, for example, when the couple's taxable wealth is likely to undergo inherent depreciation, equalization based on the value of the couple's taxable wealth at the death of the first spouse to die is inappropriate. Full deferral, the simplest alternative, however, may be equally inappropriate.

If meaningful predictions about the rate of depletion, the life expectancy of the surviving spouse, and the expected asset depreciation can be formulated, the optimal solution, from the viewpoint of the QTIP remaindermen, may be to qualify enough property for the marital deduction so that after all the depletions and depreciations have occurred, the highest estate tax bracket applicable to the surviving spouse's estate will equal that of the first spouse to die.[121] Although such predictions are exceedingly difficult, the executor may be able to make them equally well as, or better than, the testator. The difficulty of such predictions, however, suggests that executors rarely will be both willing and able to provide meaningful post-mortem assistance.

(b) Gifts by the surviving spouse

If the testator trusts the surviving spouse to provide faithfully for the QTIP remaindermen,[122] the best alternative may not require a choice between full deferral and equalization. Because ERTA increased the annual per-donee gift tax exclusion from \$3000 to \$10,000,[123] the surviving spouse can deplete substantially her potential estate at no transfer tax cost. If a couple had five children and the surviving spouse outlived the first spouse to die by ten years, a program of giving \$10,000 per year to each child would reduce the survivor's potential estate by \$500,000 with no gift or estate tax costs.[124] By depleting the

119. *See, e.g., supra* note 71 (chart showing that, under certain circumstances, equalization may be inappropriate even in a \$1,500,000 estate).

120. *See supra* notes 67-72 and accompanying text.

121. *See* Harris, *supra* note 9, at 15.

122. A testator may be willing to trust the surviving spouse to make gifts to the QTIP remaindermen if the remaindermen are the surviving spouse's children.

123. ERTA § 441(a), 95 Stat. 319 (amending pre-ERTA version of I.R.C. § 2503(b) (1982)).

124. Even when a QTIP trust is involved and the annual income is insufficient to accommodate such a giving program, a limited right of withdrawal in the surviving spouse effectively would enable her to make gifts from principal. Under I.R.C. § 2056(b)(7)(B)(ii)(II) (1982), however, the surviving spouse may not have a lifetime power of appointment over a QTIP trust.

surviving spouse's potential estate,[125] this program of annual giving would reduce the adverse effects of stacking property in the surviving spouse's higher estate tax brackets and would tend to freeze the surviving spouse's potential estate.

A major gift made by the surviving spouse promptly after the death of the first spouse to die could freeze further the survivor's estate.[126] After 1986, in addition to a program of annual gifts, up to $600,000 could be given free of transfer tax.[127] This gift would represent a significant freeze in all but the very largest combined estates. Although such a gift would not remove the amount of the property transferred from the surviving spouse's transfer tax base,[128] it would remove any subsequent appreciation or accumulated income. Even taxable gifts in excess of $600,000 would contribute to the viability of a full-deferral decision. These gifts not only would remove all income from, and appreciation on, the transferred assets from the surviving spouse's potential gross estate, but also would remove the gift tax paid if the surviving spouse lived at least three years after making the gifts.[129]

The propriety and availability of the estate planning benefits offered by programs of giving initiated by the surviving spouse depend upon the testator's answer to the question, "Do I trust my spouse to undertake a faithful and aggressive program of giving to my QTIP remaindermen?" In only one instance does the executor charged with making the QTIP election have any knowledge to contribute to the answer. If a surviving spouse entrusted to embark on a giving program announced her intention not to make these gifts after the testator's death but before the QTIP election, the executor could eliminate the need for the program by opting for equalization.

8. Income in Respect of a Decedent

Another argument against full deferral exists if the testator's estate is likely to contain a significant amount of income in respect of a decedent.[130] The recipient of income in respect of a decedent must include the income in gross income[131] but may deduct a portion of the decedent's estate tax in computing taxable income.[132] Because full deferral seeks to avoid the estate tax, recipients of income in respect of a decedent who had utilized a full-deferral

125. ERTA's amendment of I.R.C. § 2035 (1982) ensures that, even if a valuation problem later causes one or more of the annual gifts to exceed $10,000 for gift tax purposes, no estate tax inclusion of transfers within three years of death will result in other than a gross-up of any gift tax due. ERTA § 424(a), 95 Stat. 317 (codified at I.R.C. § 2035(d) (1982)).

126. Because the property received by the surviving spouses acquires a step-up in basis under I.R.C. § 1014 (1982), such a gift may be more advantageous than a "split" gift made under I.R.C. § 2513 (1982) during the lifetime of the first spouse to die. *See* Backman & Frank, *supra* note 62, at 201.

127. *See* I.R.C. § 2010(a) (1982) (unified credit); *id.* § 2001(c)(1) (rate table).

128. *See id.* § 2001(b)(1)(A)-(B).

129. *See id.* § 2035(c), (d). *See also supra* note 125.

130. *See* Gamble, *supra* note 52, at 47-48 n.8.

131. *See* I.R.C. § 691(a) (1982).

132. *See id.* § 691(c).

estate plan would be denied the income tax deduction.[133] Equalization generates an estate tax; therefore, an estate that utilizes equalization does not forfeit the income-in-respect-of-a-decedent deduction.

Clients likely to have a large amount of income in respect of a decedent generally can approximate the amount of this income with sufficient accuracy to plan their estates. An executor, however, will have a more accurate perception of the scope of the problem. Thus, in theory, reliance on the executor to make the QTIP election in estates with large amounts of income in respect of a decedent offers flexibility not otherwise available.

9. Basis

Appreciated property included in the gross estate of the surviving spouse receives a step-up in basis to the fair market value of the property at the death of the surviving spouse.[134] Thus, any appreciation occurring between the deaths of the spouses escapes income tax. If property is likely to appreciate, full deferral therefore confers an additional advantage over equalization—a larger portion of any gains not realized during the surviving spouse's lifetime will be forgiven for income tax purposes. But because any gains that by-pass the surviving spouse's estate will not be subject to the estate tax,[135] the relative benefits of equalization also are maximized. Given that the maximum net income tax bracket for capital gains generally is twenty percent,[136] and, after 1985, the lowest effective estate tax bracket will be thirty-seven percent,[137] the prospect of a stepped-up basis will be a significant factor in making the full deferral/equalization decision only in an otherwise close case. Moreover, the value of the stepped-up basis is extremely difficult to quantify.[138] Not only must the amount of appreciation between the deaths of the spouses be predicted, but also the length of time between the death of the surviving spouse and any sale must be estimated to discount the value of the additional estate tax that full deferral might generate at the surviving spouse's death.[139] If the property depreciates after the death of the surviving spouse or if the seller is in a low income tax bracket, little or no income tax will be due in any event.

Reliance on fiduciary exercise of the QTIP election cannot help determine the effect that basis should have in deciding the appropriate size of the marital deduction. In many cases the client's ability to predict the long-term growth or decline in the value of his assets is superior to that of the executor. The

133. *See id.* § 691(c)(1)(A), (2)(A).

134. *See id.* § 1014(a), (b)(1), (b)(9), (b)(10). The Technical Corrections Act of 1982, Pub. L. No. 97-448, § 104(a)(1)(A), 96 Stat. 2365, 2379, added I.R.C. § 1014(b)(10) (1982) to ensure that QTIP included in a surviving spouse's gross estate under I.R.C. § 2044 (1982) would receive a step-up in basis. *See* S. REP. No. 592, 97th Cong., 2d Sess. 20, *reprinted in* 1982 U.S. CONG. CODE & AD. NEWS 4149, 4166-67.

135. *See supra* notes 67-72 and accompanying text.

136. *See* I.R.C. § 1, 1202(a) (1982). In some cases, however, the alternative minimum tax imposed by *id.* § 55 also may apply.

137. *Compare* I.R.C. § 2010(a), (b) (1982) *with id.* § 2001(c)(1).

138. *See* Garlock, *supra* note 9, at 241.

139. *See id.*

client built, bought, or inherited the assets and, in many cases, is more familiar with them. The executor will be able to observe any changes in value that occur after the client's death. It is not clear, however, whether fluctuations occurring shortly after the client's death should influence the decision or whether the executor's assessment of the assets' prospects should be substituted for those of the client. Only the client can resolve these questions.

10. Investment Considerations

Some commentators have argued that full deferral makes the federal government the surviving spouse's investment partner by allowing her to keep money that in a sense belongs to the federal treasury.[140] The surviving spouse, therefore, may be willing to invest these funds more aggressively. Although this freedom may be attractive to some testators, unless the funds are bequeathed outright to the surviving spouse, restrictions on fiduciary investment probably will result in conservative investment decisions in any event.[141] Moreover, the question, "Do I want to increase the odds that my property will be invested aggressively during my spouse's lifetime?" can be answered only by the testator.

C. *Ease of Planning and Drafting*

Simplicity is another reason for the popularity of the full-deferral estate plan that relies upon fiduciary exercise of the QTIP election. Because of the unlimited marital deduction, the surviving spouse can receive all of an estate's income, undiminished by estate taxes, for life. Moreover, the testator can be assured that others (typically his children) eventually will receive the estate. Thus, the full-deferral estate plan assures the draftsman that the typical testator's dispositive goals are approximated, and that those primarily interested are included. The purported ability of the executor to switch from full deferral to some form of equalization by exercise of the QTIP election after the testator's death eases the occasional worry that full deferral may not be perfectly tailored to the estate at hand.

Although full deferral simplifies estate planning and drafting, it is not appropriate for all couples, particularly the very wealthy. Draftsmen therefore must not be lured into using it as a substitute for thoroughly assessing the client's ultimate dispositional priorities. As courts have become increasingly willing to impose liability on draftsmen for negligent estate planning,[142] a

140. *See* Blattmachr & Lustgarten, *Many Questions*, *supra* note 3, at 22.

141. *See generally infra* note 190 and accompanying text.

142. *E.g.*, Heyer v. Flaig, 70 Cal. 2d 223, 74 Cal. Rptr. 225, 449 P.2d 161 (1969); Stowe v. Smith, 184 Conn. 194, 441 A.2d 81 (1981); Needham v. Hamilton, 459 A.2d 1060 (D.C. 1983); McAbee v. Edwards, 340 So. 2d 1167 (Fla. Dist. Ct. App. 1976); Ogle v. Fuiten, 112 Ill. App. 3d 1048, 445 N.E.2d 1344 (1983); Woodfork v. Sanders, 248 So. 2d 419 (La. Ct. App.), *cert. denied*, 259 La. 759, 252 So. 2d 455 (1971); and Guy v. Liederbach, 501 Pa. 47, 459 A.2d 744 (1983), all held that intended beneficiaries stated cognizable claims against lawyers whose malpractice in planning, drafting, or supervising the execution of wills caused losses to the beneficiaries. See also Lucas v. Hamm, 56 Cal. 2d 583, 15 Cal. Rptr. 821, 364 P.2d 685, *cert. denied*, 368 U.S. 987 (1961),

draftsman risks a malpractice claim for rote prescription of a dispositionally inappropriate, tax-inefficient marital deduction scheme.[143]

IV. WILL RELIANCE ON FIDUCIARY EXERCISE OF THE QTIP ELECTION WORK?

Existing commentary has not analyzed the fiduciary duty problems that arise when an executor makes the QTIP election.[144] As a fiduciary, the executor presumably is subject to various fiduciary duties in determining whether to make the election.[145] Among these duties are the duty to minimize taxes, to treat beneficiaries impartially, and to serve the estate loyally. Possibly because of these duties, one observer has noted that "the new qualified terminable interest property election is potentially the most difficult election that the professional fiduciary will be called upon to make."[146]

A. *The Fiduciary Duty to Minimize Taxes*

Although neither the major treatises[147] nor the Restatement[148] articulates a discrete fiduciary duty to minimize taxes, it is obvious that one does exist.[149]

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which, despite its denial of lawyer liability on facts involving the rule against perpetuities, is a landmark case for the proposition that lack of privity is not a bar to a legal malpractice suit by a disappointed beneficiary. *See generally* Johnston, *Legal Malpractice in Estate Planning—Perilous Times Ahead for the Practitioner*, 67 IOWA L. REV. 629 (1982); Eckhardt, *The Estate Planning Lawyer's Problems: Malpractice and Ethics*, 8 INST. ON EST. PLAN. ¶ 74.600 (1974).

143. Bucquet v. Livingston, 57 Cal. App. 3d 914, 129 Cal. Rptr. 514 (Ct. App. 1976), held that trust remaindermen stated a cause of action by alleging that a lawyer's faulty marital deduction estate planning proximately caused them loss by failing to accomplish the grantor's goal of minimizing the estate tax at both his and his wife's death.

144. *See supra* note 10.

145. It could be argued that Congress, by requiring executors to make the QTIP election, preempted the states from enforcing their fiduciary conduct rules insofar as they may relate to the election. Preemption might be grounded on a combination of either the "power to lay and collect taxes," U.S. CONST. art. I, § 8, cl. 1, or the commerce clause, U.S. CONST. art. I, § 8, cl. 3, and the supremacy clause, U.S. CONST. art. VI, cl. 2. *See generally* L. TRIBE, AMERICAN CONSTITUTIONAL LAW §§ 6-23 to -27 (1978). The United States Supreme Court, however, "is generally reluctant to infer preemption." Exxon Corp. v. Governor of Maryland, 437 U.S. 117, 132 (1978). Moreover, the law of decedents' estates traditionally has been a matter of local concern. *See* United States v. Oregon, 366 U.S. 643, 649, 654 (1961); *see also* P. BATOR, P. MISHKIN, D. SHAPIRO & H. WECHSLER, HART AND WECHSLER'S THE FEDERAL COURTS AND THE FEDERAL SYSTEM 1186-89 (2d ed. 1973); Martin, *Perspectives on Federal Disclaimer Legislation*, 46 U. CHI. L. REV. 316, 352 n.150 (1979). The Supreme Court begins with the assumption that the state law is "not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress." Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947). With respect to the QTIP election, no hint appears in either the Internal Revenue Code or the legislative history that Congress intended to release executors from their fiduciary obligations in making the election. *Cf. Marital Deduction Problems*, PROB. & PROP., Winter 1982, at 10, 24 ("Federal law does not grant the power to make a partial [QTIP] election . . . .").

146. Ritchie, *Reviewing Wills and Trust Agreements by Trust Legal Counsel*, TR. & EST., Nov. 1982, at 35, 38.

147. G. BOGERT & G. BOGERT, THE LAW OF TRUSTS AND TRUSTEES (2d ed. & rev. 2d ed. 1980) [hereinafter cited as BOGERT]; A. SCOTT, THE LAW OF TRUSTS (3d ed. 1967).

148. RESTATEMENT (SECOND) OF TRUSTS (1959) [hereinafter cited as RESTATEMENT].

149. *See* Copley v. Copley, 126 Cal. App. 3d 247, 178 Cal. Rptr. 842 (Ct. App. 1981); *In re* Veith's Estate, 26 Fla. Supp. 145, 149 (Judges' Ct. 1965); Estate of Rappaport, 121 Misc. 2d 447, 467 N.Y.S.2d 814 (Sur. Ct. 1983); Browne, *Effect of Elections by an Executor Upon the Estate and Upon the Beneficiaries*, 23 INST. ON FED. TAX'N 1239, 1243, 1249-51 (1965); Carrico & Bondurant,

This duty can be inferred from the recognized duties to preserve assets,[150] to defend against claims,[151] and to use reasonable care and skill in administration.[152] Nevertheless, the duty to minimize taxes has received relatively little attention.[153]

In only a few instances has judicial scrutiny of an executor's fiduciary conduct in tax matters broken down because of the absence of a coherent body of law.[154] Nevertheless, some of the most complex cases decided in this area—those involving executor responsibilities such as the alternate valuation election[155] and the election to deduct administration expenses for income tax purposes[156]—usually have had relatively small monetary consequences.[157] The QTIP election, in conjunction with the unlimited marital deduction, however, permits an executor to decide whether all, part, or none of an estate will be subject to federal estate tax. Executors of large estates involving QTIP thus have the option of paying no tax, some tax, or a tax approaching fifty percent of the total value of the estate. Because the QTIP election will be less likely to go unnoticed than other executor duties, it may cause commentators and courts to examine and define the fiduciary duty to minimize taxes more closely.[158]

The executor whose mistakes in administering the estate's tax affairs cause the estate to incur additional taxes or expenses generally is liable for the additional taxes or expenses. The executor who fails to file a tax return or fails to pay a tax and thereby causes the estate to incur additional expenses is liable

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Equitable Adjustments: A Survey and Analysis of Precedents and Practice, 36 TAX LAW. 545, 545-46 (1983); Dobris, *Equitable Adjustments in Postmortem Income Tax Planning: An Unremitting Diet of Warms*, 65 IOWA L. REV. 103, 113-16 (1979); Report of Subcommittee on Trust Administration and Accountability of Trustees, *Tax Burden Genesis of Beneficiary Conflicts*, 102 TR. & EST. 989, 991-96 (1963) [hereinafter cited as Subcommittee Report]; Taggart, *Fiduciary's Liability in Utilizing Post-Mortem Estate Planning Techniques*, in POST-MORTEM ESTATE PLANNING 1981 393, 403 (1981); Comment, *Surcharging an Executor for Negligent Administration of Tax Responsibilities*, 45 TEMP. L.Q. 42 (1971). *Cf.* Joint Report, *supra* note 8, at 10 ("The statutes do not unequivocally state that estate tax minimization is a personal representative's duty, but considering potential impact of estate taxes certainly is a duty that can be implied."); Note, *Administration of Estates: Income and Estate Taxation: Discretionary Deductions of Administration Expenses As Affecting Substantive Rights of Individual Beneficiaries*, 4 U.C.L.A. L. REV. 111, 111 n.3 (1956) (asking whether such a duty exists).

150. *See* BOGERT, *supra* note 147, § 582; RESTATEMENT, *supra* note 148, § 176; 2 A. SCOTT, *supra* note 147, § 176.

151. *See* RESTATEMENT, *supra* note 148, § 178 & comment c; 2 A. SCOTT, *supra* note 147, § 178.

152. *See* BOGERT, *supra* note 147, § 541; RESTATEMENT, *supra* note 148, § 174; 2 A. SCOTT, *supra* note 147, § 174; UNIFORM PROBATE CODE §§ 3-703(a), 7-302 (West 1982).

153. Comment, *supra* note 149; Annot., 55 A.L.R.3d 785 (1974), and Annot., 47 A.L.R.3d 507 (1973), appear to be the fullest published discussions of the fiduciary duty to minimize taxes.

154. Will of Raible, N.Y.L.J., May 10, 1977, at 14, col.1 (Sur. Ct. 1977), and Estate of Colp, N.Y.L.J., Jan. 20, 1976, at 8, col.2 (Sur. Ct. 1976) may be examples. *See infra* notes 185 & 192.

155. I.R.C. § 2032 (1982).

156. *Id.* § 642(g).

157. *See, e.g.*, Estate of Colp, N.Y.L.J., Jan. 20, 1976, at 8, col. 2 (Sur. Ct. 1976) ($8,500 could have been saved by use of alternate valuation election in estate valued at $1,100,000 on alternate valuation date).

158. *Cf.* Engel, *Estate Planning under ERTA: Questions Without Answers*, TR. & EST., Jan. 1982, at 30, 31 (asking whether executor has "a fiduciary obligation" to make QTIP election).

for those expenses.[159] Similarly, an executor who files a tax return or pays a tax in an untimely fashion and thereby harms the estate is subject to surcharge.[160] If an executor fails to claim a clearly allowable deduction or credit in computing a tax, he is liable for the excess tax;[161] liability also may be imposed for payment of tax on an item of income or property that clearly is not subject to tax.[162]

The fiduciary duty to minimize taxes, however, is not absolute.[163] The executor will not be surcharged for additional expenses caused by late payment of taxes if the estate did not have sufficient funds to pay the taxes when due.[164] If an estate is involved in litigation or negotiations such that a tax cannot reasonably be paid in a timely fashion, the executor also may be excused from liability for the resulting expenses.[165] Finally, if the estate must pay an avoidable tax to gain a greater offsetting advantage,[166] or to avoid a

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159. *See, e.g.*, *In re* Estate of Pitt, 1 Ariz. App. 533, 405 P.2d 471 (1965); *In re* Estate of Harvey, 224 Cal. App. 2d 555, 36 Cal. Rptr. 788 (Dist. Ct. App. 1964); Sanford v. Sanford's Adm'r, 262 S.W.2d 827 (Ky. 1953).

160. *See, e.g.*, Estate of Lock, 122 Cal. App. 3d 892, 176 Cal. Rptr. 358 (Ct. App. 1981); *In re* Ducas' Estate, 109 N.Y.S.2d 17 (Sur. Ct. 1950), *aff'd mem. sub nom. In re* Gorski, 279 A.D. 730, 108 N.Y.S.2d 1016 (1951); Hooker v. Hoskyns, 328 P.2d 404 (Okla. 1958); *In re* Estate of Jones, 400 Pa. 545, 162 A.2d 408 (1960).

Although the great majority of cases that involve late payment, nonpayment, late filing, or nonfiling concern only the interest or penalties caused by the fiduciary's conduct, others have required executors to reimburse their estates for the additional estate tax incurred as a result of having forfeited the alternate valuation election. *See, e.g.*, Estate of Gerber, 73 Cal. App. 3d 96, 140 Cal. Rptr. 577 (Ct. App. 1977); *In re* Estate of Lohm, 440 Pa. 268, 269 A.2d 451 (1970).

161. *See In re* Estate of Frohnknecht, 7 Misc. 2d 896, 162 N.Y.S.2d 400 (Sur. Ct. 1957) (income tax—failure to claim distributions deduction for capital gains allocable to principal distributions); *In re* Estate of Jones, 400 Pa. 545, 162 A.2d 408 (1960) (inheritance tax—failure to claim, as a deduction for debts, excess of amount actually required to settle a claim over the amount initially claimed as debt deduction); McCune Estate, 76 Pa. D. & C. 39 (Orphans' Ct. 1950) (inheritance tax—failure to claim widow's allowance). *Cf. In re* Estate of Maurice, 433 Pa. 103, 249 A.2d 334 (1969) (remanding for inquiry into why executor failed to claim credit for property previously taxed under 1969 version of I.R.C. § 2013 (1982)). *But see* Ohio Valley Nat'l Bank of Henderson v. Edwards, 492 S.W.2d 195, 198 (Ky. Ct. App. 1973) (when executor failed to claim business loss deductions in computing the tax on decedent's final income tax return, surcharge was inappropriate because the contention that such deductions had been allowable constituted "an impermissible collateral attack on the income tax determination").

162. *See, e.g.*, *In re* Estate of Estes, 134 Ariz. 70, 654 P.2d 4 (Ct. App. 1982); *In re* Buhl's Estate, 300 Pa. 29, 150 A. 86 (1930).

163. *See In re* Estate of Wehrhane, 41 N.J. Super. 158, 165, 124 A.2d 334, 338 (Ch. Div. 1956) (rejecting contention that fiduciary must "at its peril" resolve correctly "the ultimate merits" of allowability of deduction). *See also* Browne, *supra* note 149, at 1251.

The courts, however, are much less interested in determining why a fiduciary failure has occurred in tax minimization cases. *Compare* Estate of Yalden, N.Y.L.J., June 24, 1976, at 13, col. 3 (Sur. Ct. 1976) (no discussion of reason for surcharge for failure to minimize taxes) *with* Estate of Beach, 15 Cal. 3d 623, 542 P.2d 994, 125 Cal. Rptr. 570 (1975), *cert. denied sub nom.* Edwards v. Superior Court, 434 U.S. 1046 (1978) (detailed analysis concerning an executor's investment duties). *See generally* Comment, *supra* note 149.

164. *See, e.g.*, Succession of Benoit, 196 La. 509, 199 So. 625 (1940); *In re* Estate of Pettigrew, 115 N.J. Eq. 401, 171 A. 152, *aff'd per curiam*, 116 N.J. Eq. 566, 174 A. 478 (1934); *In re* Gibson's Will, 40 N.Y.S.2d 727 (Sur. Ct. 1943). If the lack of funds was caused by improper distributions by beneficiaries, however, the executor may be surcharged. *See, e.g.*, *In re* O'Neill's Estate, 266 Pa. 9, 109 A. 526 (1920).

165. *See, e.g.*, *In re* Stevens' Estate, 95 F. Supp. 694 (D.D.C. 1951); Chemical Bank & Trust Co. v. Ott, 274 N.Y. 572, 10 N.E.2d 557 (1937).

166. *See* Powel's Estate, 28 Pa. D. & C. 623 (Orphans' Ct. 1937) (unnecessary stock transfer tax of $123 paid to obtain speedy sale of stock, which resulted in $600 gain to estate).

greater expense,[167] the executor will not be surcharged.

Courts frequently state that a fiduciary must have been negligent in handling tax matters before he will be surcharged.[168] For example, if the taxability of income or property is subject to question, a court may absolve the executor who pays the tax if he acts in "good faith" and "believes with justification that such sums were due."[169] It has even been suggested that in some instances the techniques required to minimize taxes are so complex that it is reasonable for an executor not to utilize them.[170]

The fact that many executors have escaped liability for failure to minimize taxes has led one commentator to state that there is "a substantial discretionary element to the powers the fiduciary must exercise to discharge the duty to save taxes."[171] One court has stated that "tax considerations are not the be all and end all."[172] Indeed, the primary task of the executor is to administer the estate,[173] maximizing it where possible. If minimizing taxes interferes with that task, taxes need not be minimized. For example, if defending against a

167. *See* Selleck v. Hawley, 331 Mo. 1038, 56 S.W.2d 387 (1932) (cost of defending against tax exceeded amount of tax); Estate of Berkowitz, 36 Luz. L. Reg. Rep. 125 (Pa. Orphans' Ct., Luzerne County 1941), *aff'd*, 344 Pa. 481, 26 A.2d 296 (1942); RESTATEMENT, *supra* note 148, § 178 comment c; Subcommittee Report, *supra* note 149, at 993-94 (considering possibility that income tax savings to the estate might justify increased estate taxes incurred as a result of executor's election, for alternate valuation purposes, of higher estate tax value). *See also In re* Estate of Fullerton, 375 P.2d 933, 947 (Okla. 1962) (failure to file corrected return excluding item from gross estate excused where "a good overall settlement of the estate tax liability had been made that might have been lost if the matter of tax liability were reopened").

168. *E.g.*, *In re* Estate of Stephens, 117 Ariz. 579, 574 P.2d 67 (Ct. App. 1978) (remanding for findings on fiduciary negligence); *In re* Wheeler's Will, 19 Misc. 2d 335, 340, 186 N.Y.S.2d 134, 140 (Sur. Ct. 1959) ("Unless there is impropriety or negligence in the conduct of the estate representative followed by loss to the estate, there can be no surcharge."); *In re* Estate of Lohm, 440 Pa. 268, 273, 269 A.2d 451, 454 (1970) (fiduciary surcharged for negligent tax overpayment). *But see In re* Estate of Oakes, 127 Misc. 779, 781, 217 N.Y.S. 638, 640 (Sur. Ct. 1925) ("Irrespective of the fact that . . . it was the result of ill advice of counsel and not to negligence on the part of the executor . . ., the residuary legatees should not be compelled to bear this loss."), *aff'd mem.*, 220 A.D. 758, 222 N.Y.S. 864 (1927), *rev'd on other grounds*, 248 N.Y. 280, 162 N.E. 79 (1928).

169. *In re* Estate of Miller, 259 Cal. App. 2d 536, 550-51, 66 Cal. Rptr. 756, 766 (Ct. App. 1968). *See also* United States v. Mason, 412 U.S. 391, 398-99 (1973) ("[M]ost courts which have considered the problem have given a trustee broad discretion to pay taxes . . . so long as the trustee's judgment that the taxes are valid . . . is not wholly unreasonable."); Henshie v. McPherson & Citizens State Bank, 177 Kan. 458, 479, 280 P.2d 937, 953 (1955) (trustees "exercised their judgment" and paid disputed taxes in good faith); *In re* Estate of Pettigrew, 115 N.J. Eq. 401, 404, 171 A. 152, 154 (Prerog. Ct. 1934) ("The executors were not under a legal duty to decide with faultless judgment and legal nicety the legality or constitutionality of the Kansas statute in question before paying the tax under it. They were only required to act in good faith and as the average person of ordinary prudence and caution would under like circumstances have done . . . ."), *aff'd per curiam*, 116 N.J. Eq. 566, 174 A. 478 (1934); Scudder v. Ames, 142 Mo. 187, 231, 43 S.W. 659, 671-72 (1897) (allowing payment of real estate taxes later declared void, because "paid in good faith" and "under the belief that the . . . estate was legally liable therefor"). *But see* Mason v. United States, 461 F.2d 1364 (Ct. Cl. 1972) (where issue of taxability is raised, fiduciary's duty is to refuse to pay the tax), *rev'd*, 412 U.S. 391 (1973); *In re* Estate of Estes, 134 Ariz. 70, 78-79, 654 P.2d 4, 12-13 (Ct. App. 1982) (executor surcharged for inclusion of certain life insurance policies in the gross estate for estate tax purposes, even though a "question" existed as to their includibility; executor also had refused to pursue refund).

170. Taggart, *supra* note 149, at 403.

171. Dobris, *supra* note 149, at 115.

172. Estate of Colp, N.Y.L.J., Jan. 20, 1976, at 8, cols. 2, 3 (Sur. Ct. 1976).

173. *See* RESTATEMENT, *supra* note 148, § 6 comment b; UNIFORM PROBATE CODE § 3-703(a) (West 1982).

tax would cost more than the amount of the tax, there is no duty to minimize taxes.[174] A reduction of taxes in such a case would not maximize the estate.

Even estate maximization, however, is subsidiary to orderly estate administration.[175] Although minimization of taxes may be possible at a minimal cost to the estate, nevertheless, it may interfere with orderly administration. In such cases, tax minimization is not required.[176] For example, an executor generally can avoid income tax on the estate by making annual distributions equal to the estate's distributable net income.[177] A duty to reduce the estate's income tax in this manner, however, often would force the executor to make distributions prior to the time they otherwise would be appropriate. Perhaps for this reason, no case or commentator has extended the fiduciary duty to minimize taxes to require estate distributions solely to reduce the estate's income tax.[178] Similarly, there is no fiduciary duty to avoid capital gains tax on the sale of estate assets by distributing them in kind[179] if the sale reasonably appears to the fiduciary to be in the best interests of the estate.[180] In both cases, minimization of taxes "costs" the estate something. To obtain a distributions deduction, the executor has to part with property.[181] Similarly, to avoid capital gains tax, the executor must forego certain sales.[182] Because the executor's primary duty to administer the estate could be prejudiced, minimization of taxes in such cases is not required.

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174. *See supra* note 167.

175. *See* RESTATEMENT, *supra* note 148, § 188 ("The trustee can properly incur expenses which are necessary or appropriate to carry out the purposes of the trust . . . .").

176. For example, when a decedent left a haberdashery business to three employees of the business, and "it was important for the temporary administrators to have always on hand sufficient cash to meet current obligations," *In re* Estate of Kennedy, 116 Misc. 267, 269, 189 N.Y.S. 671, 672 (Sur. Ct. 1921), the court approved the temporary administrators' decision not to pay taxes as they fell due, even though tax penalties thereby were incurred. Subsequently the estate was able to pay both the taxes and the penalties. Similarly, when a trustee was charged with maintaining the decedent's residence during the widow's lifetime and paying an annuity to the widow, the court upheld the trustee's "business judgment," *In re* Weir's Will, 182 Misc. 845, 852, 46 N.Y.S.2d 551, 557 (Sur. Ct. 1943), to use its liquid funds for those purposes rather than in paying real estate taxes on unimproved land during a depressed market. *Cf. In re* Gibson's Will, 40 N.Y.S.2d 727, 736 (Sur. Ct. 1943) ("The amount of principal, if any, that should be applied in payment of tax arrears is a question of business judgment to be determined by the trustee, with the proper exercise of which this Court will not interfere."). Likewise, when the trustee of seven trusts sought to liquidate a holding company in which the trusts owned a majority interest to improve the individual administration of each trust, judicial approval was granted over the objection of the guardian ad litem that the liquidation would cause unnecessary taxes. Estate of Fales, 106 Misc. 2d 419, 431 N.Y.S.2d 763 (Sur. Ct. 1980).

177. *See* I.R.C. §§ 641(b), 643(a)-(b), 661-663 (1982).

178. Several cases have surcharged executors for taxes unnecessarily incurred after the time that the estate reasonably should have been distributed. *E.g., In re* Macky's Estate, 73 Colo. 1, 213 P. 131 (1922); Schott v. Schott's Ex'r, 298 Ky. 55, 182 S.W.2d 220 (1944); Booker v. Armstrong, 93 Mo. 49, 4 S.E. 727 (1887); *In re* Williams' Estate, 55 Mont. 63, 173 P. 790 (1918). These cases, however, appear to be failure-to-distribute-in-a-timely-manner cases rather than failure-to-minimize-tax cases.

179. Generally, an executor must honor a request for a distribution in kind, unless sale of the asset is reasonably necessary to pay the estate's debts, administration expenses, or legacies. *See, e.g., In re* Minichello's Estate, 368 Pa. 639, 644, 84 A.2d 511, 513 (1951).

180. *In re* Estate of Vandergrift, 406 Pa. 14, 177 A.2d 432 (1962) (trust). *See also In re* Kurrus' Will, 42 Misc. 2d 832, 249 N.Y.S.2d 272 (Sur. Ct. 1964) (trust).

181. *See* I.R.C. § 661(a) (1982).

182. *See id.* §§ 61(a)(3), 1001(a).

On the other hand, if tax minimization can be achieved at no "cost" to the estate, no reason exists why an executor should not be required to do so.[183] In *Estate of Yalden*[184] an executor was surcharged for failure to elect alternate valuation. Apparently, the court believed that the election could have been made at no "cost" to the estate.[185] Another method of minimizing taxes at no "cost" to the estate is to elect to deduct administration expenses for income tax rather than estate tax purposes. Thus, in *In re Estate of Wallis*[186] the Pennsylvania Supreme Court reversed the trial court's award of "additional compensation" to the executor because the executor had deducted administration expenses for estate tax rather than income tax purposes, even though the estate had been in a ninety percent income tax bracket but only a forty-nine percent estate tax bracket.[187]

183. On the contrary, there are excellent reasons for requiring the executor to minimize taxes in such a situation. For a fact pattern demonstrating the need for a requirement that, in the absence of offsetting "cost" to the estate, the executor must use the alternate valuation election to minimize taxes, see Fisher, *Human Drama in Death and Taxes*, 114 TR. & EST. 298, 360 (1975). A surviving spouse serving as executor of an estate valued at $435,000 at the date of death but only $200,000 on the alternate valuation date is said to have incurred $28,500 in avoidable taxes by declining to elect alternate valuation. Because the surviving spouse was the beneficiary of a pecuniary-formula maximum marital deduction clause, she succeeded not only in increasing her own financial interest in the estate but also in cutting her sister-in-law, the residuary beneficiary, entirely out of the estate.

184. N.Y.L.J., June 24, 1976, at 13, col. 3 (Sur. Ct. 1976).

185. Browne, *supra* note 149, at 1243, agrees that, if there is no cost to the estate, the executor breaches his fiduciary duty if he fails to use the alternate valuation election to minimize the estate tax. The alternate valuation election, however, is not always free of cost to the estate, for the election also determines the estate's income tax basis in its assets. *See* I.R.C. § 1014(a)(1)-(2) (1982). Thus, if an estate is in a high income tax bracket and sells a portion of its assets, the executor may be able to minimize the estate's overall tax burden by electing the higher estate tax valuation. *See, e.g.*, Browne, *supra* note 149, at 1242-43; Subcommittee Report, *supra* note 149, at 993-94. *In re* Estate of Levine, 26 Misc. 2d 307, 203 N.Y.S.2d 643 (Sur. Ct. 1960), appeared to present the issue whether an executor in such a position should be surcharged for not electing the higher value. The date-of-death value of the estate was only $28,000, however, and the court refused to surcharge the executor for failing to elect an alternate valuation that Treas. Reg. § 20.2032-1(b)(1) (1972) denied to an estate of that size. *Levine*, 26 Misc. 2d at 318-19, 203 N.Y.S.2d at 655-56. Estate of Colp, N.Y.L.J., Jan. 20, 1976, at 8, col. 2 (Sur. Ct. 1976), also involved the alternate valuation election. There, although the alternate valuation was higher, the income taxes that would have been saved by the estate would have exceeded the resulting estate taxes by $8,500. *Id.* at col. 3. Nevertheless, the Surrogate strongly suggested that election of the lower valuation was required, because one of the executors was the surviving spouse, whose interest under the will would have been increased by electing the higher valuation. *Id.* at col. 3. The precedential value of *Colp*, however, is limited. Not only did the Surrogate expressly limit his "remarks" to "the facts of the case"; by dismissing the petition, he purported to leave the executors free to decide how to make the election. *See id.* at cols. 3-4. Later, in Estate of Fales, 106 Misc. 2d 419, 431 N.Y.S.2d 763 (Sur. Ct. 1980), the same Surrogate, referring to *Colp*, wrote: "It may well be . . . that fiduciaries should minimize taxes for their estates whether or not their choice benefits themselves. . . ." *Id.* at 422, 431 N.Y.S.2d at 764.

Election of the higher estate tax valuation could confer other benefits on an estate, such as increased depreciation deductions, qualification for an I.R.C. § 303 (1982) corporate stock redemption, qualification for I.R.C. § 2032A (1982) special use valuation, or qualification for I.R.C. § 6166 (1982) estate tax deferral. *See generally* Browne, *supra* note 149, at 1245; Koehler, *Alternative Tax Elections and Adjustments Required Among Estate Beneficiaries*, in THE PLANNING AND ADMINISTRATION OF A LARGE ESTATE 391, 406-08 (1982).

186. 421 Pa. 104, 218 A.2d 732 (1966).

187. *Id.* at 112-13, 218 A.2d at 736. *See also In re* Estate of Bixby, 140 Cal. App. 2d 326, 351, 295 P.2d 68, 74 (Dist. Ct. App. 1956) ("[I]t would be judicious [for the executor] to avail himself of the [I.R.C. § 642(g) (1982)] deduction in the place where the optimum advantage will accrue to the

The QTIP election similarly has no extraneous "cost" to the estate. The election consists of deciding how much of a predetermined amount of property—which in any event will remain in the fiduciary's hands (except for any taxes generated) until distribution in due course—is to qualify for the marital deduction. Consequently, an executor who incurs an avoidable estate tax by failing to elect QTIP status for any portion of a qualifying interest breaches the fiduciary duty to minimize taxes.[188]

Another argument suggests that an executor may not use the QTIP election to cause prepayment of the estate tax. Generally, fiduciaries must invest in income-producing assets[189] and may not speculate.[190] Intentional prepayment of an avoidable tax to optimize property at the death of the surviving spouse, however, arguably is a speculative[191] "investment" in a nonincome-producing "asset" that cannot be "liquidated" and may not yield a "gain." Therefore, by analogy to the fiduciary investment duties, an executor should not be allowed to use the QTIP election to cause prepayment of estate taxes.[192]

Stated in an alternate form, fiduciary prepayment of estate taxes to optimize the ultimate family wealth may not be "reasonable." Although the amount of tax prepaid would be immediate and certain, the potential property augmentation after the death of the surviving spouse would depend on numerous unknowables.[193] Consequently, a court could find that an executor who prepaid estate taxes was engaged in unreasonable speculation in violation of his fiduciary duty.

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estate, that is, by diminishing the aggregate of taxes payable to the federal government."); Browne, *supra* note 149, at 1250; J. PRICE, *supra* note 6, at 726.

188. *See* Dobris, *supra* note 3, at 825 (executor "may have a duty to minimize estate taxes in the first spouse's estate") & n.194; *Marital Deduction Problems, supra* note 145, at 24.

189. *See* Miller v. Phillips, 235 Ala. 298, 178 So. 531 (1938) (administrator); *In re* Macky's Estate, 73 Colo. 1, 213 P. 131 (1922) (executor); *In re* Estate of Tolfree, 347 Mich. 272, 27 N.W.2d 629 (1956) (executors); *In re* Estate of McCrea, 475 Pa. 383, 380 A.2d 773 (1977) (executors); *In re* Estate of Lare, 436 Pa. 1, 257 A.2d 556 (1969) (administrator); *In re* Estate of Kugler, 344 N.W.2d 160 (Wis. 1984) (administrator); BOGERT, *supra* note 147, § 611; RESTATEMENT, *supra* note 148, §§ 282, 240; 2, 3 A. SCOTT, *supra* note 147, §§ 181, 240.

190. *See* Vredenburgh v. Jones, 349 A.2d 22, 43-44 (Del. Ch. 1975); *In re* See's Estate, 38 N.Y.S.2d 47, 50 (Sur. Ct. 1942); BOGERT, *supra* note 147, § 612; RESTATEMENT, *supra* note 148, § 227(a) & comment e; 3 A. SCOTT, *supra* note 147, § 227.3.

191. *See supra* note 74. *See also* Moore, *Conflicting Interests, supra* note 6, ¶ 607. *Cf.* Kimbrough, *Optional Use of Deductions: Related Problems—Other Current Events in Estate Planning*, 17 MAJOR TAX PLAN. 625, 637 (1965) (making such an argument about use of alternate valuation election to increase beneficiaries' bases for future sales).

192. With respect to the alternate valuation election, Subcommittee Report, *supra* note 149, at 993-94, states that "if the assets are to be distributed, so that the income tax advantage is traceable only to an increased basis in the hands of the distributees, the impossibility of valuing the ultimate income tax saving should excuse the executor from increasing the immediate (estate) taxes by electing the alternate valuation date, unless [otherwise] agreed to by all interested parties." *See also* Browne, *supra* note 149, at 1243. *But see* Will of Raible, N.Y.L.J., May 10, 1977, at 14, col. 1 (Sur. Ct. 1977). In *Raible* the court stated that "it would not be imprudent" for executors to exercise the alternate valuation election in favor of the higher estate tax value to make available possible income tax savings on future sales of the estate's assets, even though there was "no evidence that [the assets] soon [would] be sold." *Id.* Because the Surrogate purported to leave the executors free to exercise the alternate valuation election "as they deem[ed] proper," *id.*, however, the precedential value of *Raible* is limited. Moreover, parties who the Surrogate strongly suggested were capable of deciding the issue had consented to the proposed election. *Id.*

193. *See, e.g., supra* text accompanying notes 120-21.

Finally, one further argument exists for barring fiduciary exercise of the QTIP election to cause prepayment of estate taxes. Prepayment cannot benefit the estate, to which the executor owes his fiduciary duties.[194] Rather, prepayment depletes the estate to benefit others, the QTIP remaindermen, sometime in the future. Since a fiduciary must account for all of the estate's funds,[195] payment of debts or taxes that were not owed by the estate[196] or administration expenses that did not benefit the estate[197] are not permitted, even if a beneficiary of the estate is benefited. In short, the "duty of the [executor] is to the estate as a whole; he cannot take sides; he is not to champion some parties and not others."[198] Thus, a potential benefit obtained for a remainderman at the expense of prepaying estate taxes probably would amount to a breach of fiduciary duty.[199]

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194. That the executor owes his fiduciary duties to the estate as an entity is apparent from *In re* Morse, 467 N.Y.S.2d 114 (Sur. Ct. 1983), which approved overall tax minimization at the expense of one of the estate's beneficiaries.

195. *See* 3 A. SCOTT, *supra* note 147, § 226 (where trustee makes payment to wrong person, he is liable "even if the mistake is a reasonable one").

196. *See, e.g., In re* Estate of Cross, 51 Cal. App. 3d 80, 123 Cal. Rptr. 825 (Ct. App. 1975) (debts concerning which the estate may have had defenses); *In re* Taylor's Estate, 30 N.J. Super. 65, 103 A.2d 268 (Mercer County Ct. 1954) (real estate taxes on property that passed directly to beneficiary); *In re* Stirling's Estate, 342 Pa. 497, 21 A.2d 72 (1941) (taxes paid on real estate not under executor's control); Carolina Life Ins. Co. v. Arrowsmith, 174 S.C. 161, 176 S.E. 728 (1934) (inheritance tax on life insurance proceeds payable to decedent's wife and mother).

197. *See, e.g., In re* Brack Estate, 121 Mich. App. 585, 329 N.W.2d 432 (Ct. App. 1982) (expenses incurred in contesting a common-law-widow status claim viewed by court as having benefited not estate but heirs); *In re* Stutchbury's Will, 138 N.Y.S.2d 653 (Sur. Ct. 1954) (post-death expenses relating to decedent's residence while occupied rent-free by decedent's executor husband, who was one of four estate beneficiaries); Herman's Estate, 90 Pa. Super. 512 (1927) (expenses of painting farm property that did not pass through estate).

198. Hildreth, *Fiduciary's Duty: Skill and Effort Owed to All*, N.Y.L.J., June 16, 1975, at 21, cols. 1, 2. *See also In re* Morse, 467 N.Y.S.2d 114, 117 (Sur. Ct. 1983). *Cf. In re* Estate of Estes, 134 Ariz. 70, 78, 654 P.2d 4, 12 (Ct. App. 1982) ("Where an executor is confronted with several alternatives, he is absolutely bound to follow the course which is most beneficial to the estate."); Estate of Colp, N.Y.L.J., Jan. 20, 1976, at 8, cols. 2, 3 (Sur. Ct. 1976) ("It is the obligation of the executors to consider the estate as a whole. Decisions should not be made with a view toward benefiting one beneficiary to the detriment of another."). *See generally* BOGERT, *supra* note 147, § 543; RESTATEMENT, *supra* note 148, § 170; 2 A. SCOTT, *supra* note 147, § 170.

199. *Cf. In re* Dwight's Trust, 204 Misc. 204, 128 N.Y.S.2d 23 (Sup. Ct. 1952) (surcharging trustee for losses borne by remaindermen as a result of investments in tax-exempt securities chosen to complement income beneficiary's high income tax bracket); RESTATEMENT, *supra* note 148, § 170, comment q (trustee is under a duty "not to be guided by the interest of any third person"); Ledwith, *Conflict of Interest Problems Not Limited to Actions Affecting Fiduciary Personally*, 10 EST. PLAN. 22 (1983) (discussing conflicts involving third-party interests).

Several commentators have suggested that the alternate valuation election may be exercised to increase estate tax presently due to offset the capital gains tax that eventually might be paid by a beneficiary who sold the distributed assets. *E.g.*, Dobris, *Limits on the Doctrine of Equitable Adjustment in Sophisticated Postmortem Tax Planning*, 66 IOWA L. REV. 273, 303 & n.199 (1981); Koehler, *supra* note 185, at 424; Moore, *Conflicting Interests in Postmortem Planning*, 9 INST. ON EST. PLAN ¶¶ 1900, 1903 (1975); Taggart, *supra* note 149, at 228. Other commentators have suggested that the executor make the I.R.C. § 642(g) election by comparing the estate tax benefits not only with the estate's income tax benefits but also with the income tax benefits that might accrue to likely beneficiaries. *See* Hale, *Executor Elections: A Checklist, When and How to Make Them*, 30 INST. ON FED. TAX'N ¶¶ 793, 813 (1972); Randall, *Consequences of Executor's Elections as to Administrative Expenses*, 15 INST. ON FED. TAX'N ¶¶ 1011, 1021 (1957). *See also* CONN. GEN. STAT. ANN. § 45-100e(35)(b) (West Supp. 1984) (authorizing executor to consider both estate and beneficiaries in using I.R.C. § 642(g) (1982) election to minimize taxes, if statute is incorporated by dispositive document). For the reasons stated in the text, such conduct could constitute a breach of the common-law fiduciary duty to minimize taxes. Subcommittee Report, *supra* note

If it is reasonable to expect that the courts will surcharge executors who choose to prepay the estate tax in an effort to optimize the QTIP remainder, or even that litigation over the propriety of such conduct will occur, estate plans that rely on fiduciary exercise of the QTIP election as a means to achieve post-mortem flexibility appear to be flawed. These plans depend on the possibility that the executor will not elect QTIP status automatically for the entire estate.[200] If the dispositive document does not contain language remitting the fiduciary duty to minimize taxes,[201] the executor may feel compelled to make the full QTIP election,[202] regardless of its propriety, unless valid consents of all beneficiaries or judicial approval can be obtained in advance.

B. The Fiduciary Duty to Treat Beneficiaries Impartially

1. In General

The fiduciary duty to treat beneficiaries impartially[203] likewise may influ-

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149, at 993-94, distinguishes the case in which sales are by the executor from the case in which sales are by distributees and concludes that the executor need consider only the former.

Vanderbilt v. Balsan, 190 Misc. 824, 77 N.Y.S.2d 403 (Sup. Ct. 1948), presented a situation somewhat similar to that of the QTIP election but resolved the question of fiduciary duty in a manner that appears to contradict the conclusion in the text. In *Vanderbilt*, an English court had determined that various English taxes, in the amount of £175,000, had become due upon the death of the Ninth Duke of Marlborough, a beneficiary of a trust administered by an American trustee. *Id.* at 826-28, 77 N.Y.S.2d at 407. If the disputed taxes were paid, no further taxes would be due on the death of the succeeding life beneficiary. If the disputed taxes were not paid, however, taxes in the amount of £326,750 would be due at the succeeding life beneficiary's death. *Id.* at 834, 77 N.Y.S.2d at 413. The court directed the trustee to pay, compromise, or otherwise discharge the disputed taxes, because to do otherwise "would expose the trust to the risk of an inordinately greater liability on the death of [the succeeding income beneficiary]." *Id.* at 850, 77 N.Y.S.2d at 427. Two distinctions limit the applicability of *Vanderbilt* to the QTIP election. First, the case involved a trustee, not an executor. Therefore, the trustee was responsible for administering the trust for the long-term benefit of both the succeeding life beneficiary and the remainderman, rather than merely until a distribution of assets could be made (prior to the imposition of the future tax). Thus, future tax was directly relevant to the trustee. *Cf.* MICH. STAT. ANN. § 27.5829(1) (Callaghan 1980) ("[A] trustee shall exercise his best judgment and discretion for what he believes to be the best interest of the trust and for the persons designated to benefit from the trust."). Second, both the succeeding life beneficiary and the indefeasibly vested remainderman consented to payment of the tax. *Id.* at 835, 77 N.Y.S.2d at 414.

200. *Cf.* Gutierrez, *supra* note 8, ¶ 1404.1(A) (executors will tend to elect full QTIP to minimize estate tax on present estate).

201. See *infra* text accompanying notes 294-300.

202. In a situation where the full unified credit otherwise would not be used, the executor might decline to elect QTIP status as to that portion of the marital trust necessary to exhaust the unified credit. Thus, the executor's decision would generate no federal estate tax.

203. *See In re* Estate of Miller, 259 Cal. App. 2d 536, 66 Cal. Rptr. 756 (Ct. App. 1968); *In re* Veith's Estate, 26 Fla. Supp. 145, 149-50 (Judges' Ct. 1965); RESTATEMENT, *supra* note 148, §§ 183, 232; 2, 3 A. SCOTT, *supra* note 147, §§ 183, 232; E. SCOLES & E. HALBACH, PROBLEMS AND MATERIALS ON DECEDENTS' ESTATES AND TRUSTS 802 (3d ed. 1981); Browne, *supra* note 149, at 1241; Carrico & Bondurant, *supra* note 149, at 546; Weigel & Trost, *Tax Elections: When and How to Make Compensatory Adjustments*, 6 EST. PLAN. 130, 130 (1979). *See generally* Dobris, *supra* note 149 (considering equitable adjustments that are required by duty of impartiality); Dobris, *supra* note 199 (considering instances in which duty of impartiality does not require equitable adjustment); Dunham, *A Trustee's Dilemma as to Principal and Income*, 26 U. CHI. L. REV. 405 (1959) (dealing with duty of impartiality in context of a fiduciary's holding of investments on which extraordinary dividends are likely); Phillips, *Some Instances of the Trustee's Duty to Act Fairly Between Different Classes of Beneficiaries*, 10 U. QUEENSLAND L.J. 83 (1977) (considering the duty to treat beneficiaries impartially in (1) powers of sale, (2) making investment decisions, and (3) voting shares held as trustee).

ence fiduciary exercise of the QTIP election.[204] By electing QTIP status for the decedent's entire estate (other than the credit-shelter portion), an executor maximizes the surviving spouse's interest[205] but may deplete substantially what the QTIP remaindermen stand to receive at the death of the surviving spouse.[206]

If courts subject the QTIP election to the rigors of the fiduciary duty to treat beneficiaries impartially, what is the correct standard to judge the propriety of an executor's decision? In the case of another election thrust upon executors by the Internal Revenue Code—that available under section 642(g) to deduct administration expenses for income tax, rather than estate tax, purposes—some courts and legislatures have required the income beneficiaries to reimburse principal for the tax cost of forfeiting estate tax deductions generated by principal expenses.[207] The rationale for this requirement is clear: the beneficiaries of an interest that bears the expense of generating a tax deduction are "entitled" to the tax benefit of that deduction,[208] at least if the denial of the deduction is the result of an executor's election rather than the mandate of the Internal Revenue Code.[209]

There is no similar "entitlement" from which to judge the impartiality of an executor's exercise of the QTIP election.[210] Consider an executor who elects to qualify the entire estate, less the credit-shelter amount, for the marital deduction. The executor thereby minimizes the estate tax on the estate of the

204. *See* Ritchie, *supra* note 146, at 38.

205. Because the surviving spouse necessarily is the sole income beneficiary of any portion of an estate subject to a QTIP election, the election augments her interest (or at least fails to decrease it) by avoiding taxes that typically are borne by the QTIP trust. Taxes generated by a partial QTIP election generally cannot be allocated to the credit-shelter portion, because the decedent's unified credit has, by definition, been exhausted if taxes are being generated, and the formula clause generally used to fund the credit-shelter portion automatically reduces the credit-shelter portion to zero. *See* Blattmachr & Lustgarten, *Selected Considerations*, *supra* note 3, at 42-43, 45 n.31.

206. *See supra* notes 64-74 and accompanying text.

207. *See In re* Warms' Estate, 140 N.Y.S.2d 169 (Sur. Ct. 1955); *In re* Estate of Bixby, 140 Cal. App. 2d 326, 295 P.2d 68 (Dist. Ct. App. 1956); *In re* Veith's Estate, 26 Fla. Supp. 145 (Judges' Ct. 1965); *In re* Kent's Estate, 23 Fla. Supp. 133 (Judges' Ct. 1964); *In re* Backus, 106 Misc. 2d 463, 434 N.Y.S.2d 106 (Sur. Ct. 1980); Matter of Herbert, N.Y.L.J., June 4, 1969, at 42 (Sur. Ct. 1969); *In re* Will of Dupuy, 29 A.D.2d 965, 289 N.Y.S.2d 581 (1968); *In re* McTarnahan's Estate, 27 Misc. 2d 13, 202 N.Y.S.2d 618 (Sur. Ct. 1960); *In re* Levy's Estate, 9 Misc. 2d 561, 167 N.Y.S.2d 16 (Sur. Ct. 1957); Bell Estate, 8 Ches. Co. 21, 7 Pa. Fiduc. 1 (Orphans' Ct. 1956), *aff'd*, 393 Pa. 623, 144 A.2d 843 (1958); MD. EST. & TRUSTS CODE ANN. § 11-106(a) (1974); N.Y. EST. POWERS & TRUSTS LAW § 11-1.2(a) (McKinney Supp. 1983). *Cf.* CONN. GEN. STAT. ANN. § 45-100e(35)(B) (West Supp. 1983-84) (if statute is incorporated in dispositive document, the adjustment is required in certain cases). *But see* MICH. STAT. ANN. § 27.5829(1)(e), (2) (Callaghan 1980) (no adjustment required).

208. *See* Dobris, *supra* note 149, at 145-47. If the executor's decision is to deduct administration expenses for estate tax purposes, no adjustment is required. *See* J. PRICE, *supra* note 6, at 725-26; Taggart, *supra* note 149, at 244. This fact confirms that the reason for the reimbursement is to restore the tax benefit of a deduction to those who have paid for it.

209. For conflicting authorities as to whether the beneficiaries of an interest that generates a tax deduction are entitled to the benefit of that deduction when the Internal Revenue Code itself shifts the benefit to other beneficiaries, *compare* Dobris, *supra* note 149, *with* Dobris, *supra* note 199. *See also* Carrico & Bondurant, *supra* note 149.

210. When the QTIP election is relied upon to fix the size of the marital deduction, the election would appear to be the sole determinant of the relative interests of the estate's beneficiaries.

first spouse to die but arguably fails to treat the estate's beneficiaries impartially, because the executor augments the surviving spouse's income interest at the possible expense of the QTIP remaindermen. The amount of depletion of the QTIP remainder, however, depends entirely on how much of the decedent's estate is "supposed" to qualify for the marital deduction. Given that the testator signed a will that relies on fiduciary exercise of the QTIP election, the testator's actual intentions on the relative interests of the beneficiaries under his will, if he had any, will be difficult to determine. Since no standard exists by which to judge the fiduciary's exercise of the QTIP election,[211] it should be reviewed under the same standard that generally applies to the exercise of fiduciary discretion.[212] Thus, fiduciary exercise of the QTIP election should be subject to judicial review only for an abuse of discretion.[213]

A similar situation exists in trust law. The duty of impartiality has limited impact in the administration of trusts that authorize the fiduciary to sprinkle income or principal among various beneficiaries.[214] The settlor's intention

211. In *In re* Veith's Estate, 26 Fla. Supp. 145 (Judges' Ct. 1965), the court held that no adjustment between the interest of the surviving spouse and the interests of the remaindermen of the nonmarital trust was required to offset the "swing" that occurred when the executor elected, under I.R.C. § 642(g), to deduct administration expenses for income tax purposes rather than for estate tax purposes. The "swing" occurred because, under the pre-ERTA quantitative restrictions on the marital deduction, only one-half of adjusted gross estate (AGE) could qualify for the marital deduction. Therefore, when administration expenses that could have reduced the AGE were deducted instead for income tax purposes, both the AGE and, pursuant to the formula clause in the decedent's will, the marital share were increased. This decreased the nonmarital share. The court reasoned that the decedent, by placing a formula clause pegged to the AGE in his will, indicated an intention that the beneficiaries' relative interests were to be defined solely by reference to the AGE, which could be calculated only after consideration of the executor's election under I.R.C. § 642(g). Thus defined, the "swing" did not rearrange the beneficiaries' relative interests; no fixed "entitlements" existed until the election had been made. Other cases also have denied an adjustment for the "swing." *See, e.g., In re* Modisette's Estate, 53 Misc. 2d 1050, 280 N.Y.S.2d 611 (Sur. Ct. 1967); *In re* Will of Kennedy, 39 Misc. 2d 688, 241 N.Y.S.2d 894 (Sur. Ct. 1963); *In re* McTarnahan's Estate, 27 Misc. 2d 13, 202 N.Y.S.2d 618 (Sur. Ct. 1960); *In re* Estate of Inman, 22 Misc. 2d 573, 196 N.Y.S.2d 369 (Sur. Ct. 1959). Only one case, *In re* Levy's Estate, 9 Misc. 2d 561, 167 N.Y.S.2d 16 (Sur. Ct. 1957), has required the adjustment, and its author later reached the opposite conclusion in *McTarnahan.* Several states have enacted statutes that deny adjustments for the "swing." MD. EST. & TRUSTS CODE ANN. § 11-106(b) (1974); MICH. STAT ANN. § 27.5829(1)(e), (2) (Callaghan 1980); N.Y. EST. POWERS & TRUSTS LAW § 11-1.2(b) (McKinney Supp. 1983). *See also* CONN. GEN. STAT. ANN. § 45-100e(35)(B) (West Supp. 1984) (applicable only if incorporated in dispositive document). Estate of Rappaport, 121 Misc. 2d 447, 467 N.Y.S.2d 814 (Sur. Ct. 1983), cited the New York cases and statute barring an equitable adjustment for the "swing," but nevertheless directed the executors to make the election in such a way that the "swing" would not cause "a grotesque perversion of the testator's plan." Apparently the court distinguished the cases and statute on the basis that they involved judicial evaluation of already accomplished elections rather than judicial supervision of exercise of the election. Why the result should depend upon the timing of judicial intervention is not apparent. The court mentioned but did not provide the details of a stipulation between the parties.

212. *See* Joint Report, *supra* note 8, at 12.

213. *See* RESTATEMENT, *supra* note 148, § 187. *Cf. In re* Veith's Estate, 26 Fla. Supp. 145, 150 (Judges' Ct. 1965) (executor's election under 1965 version of I.R.C. § 642(g)(1982) to deduct administration expenses for income tax purposes not criticized; exercise of executor's "discretion" was not "detrimental to the estate" and executor did not act "capriciously, arbitrarily, mischievously, or ruinously"); Griffith v. First Nat'l Bank & Trust Co., 249 Ga. 143, 147, 287 S.E.2d 526, 529 (1982) (reversing trial court, which should have "substituted its judgment for that of the trustee only if the trustee had exhibited some abuse of discretion such as bad faith or fraud" in making larger invasions of marital trust than of nonmarital trust).

214. *See* RESTATEMENT, *supra* note 148, §§ 183 comment a, 187; 2 A. SCOTT, *supra* note 147, §§ 183, 187; Dobris, *supra* note 149, at 107-08 n.33 (distinguishing "discretionary administrative

to remit the duty of impartiality is said to be implied in fact.[215] Similarly, the testator who is aware of the executor's obligation to make the QTIP election arguably intends for the executor to act as his delegate in making a decision that will affect the relative interests of the estate beneficiaries. In short, the testator who empowers an executor to make the election necessarily confers authority on the executor to rearrange the interests of the testator's beneficiaries. The fiduciary duty to deal impartially with beneficiaries, therefore, should require only a reasoned, disinterested decision.[216]

Although in many respects the fiduciary duties of an executor are identical to those of a trustee,[217] a distinctive characteristic of the executor's role is to parcel out estate assets in strict accordance with the testator's expressed wishes.[218] Moreover, substantial differences exist between a client's reliance on a lawyer's advice that the typical full-deferral estate plan is appropriate to provide for his surviving spouse and the decision to grant a trustee broad discretionary powers over the distribution of income or principal. Courts, therefore, may decline to interpret every full-deferral estate plan as evidence that the testator actually intended to confer a dispositive power upon the executor and thereby to remit the fiduciary duty of impartiality.

Comparison of the QTIP election with two other familiar executor elections, however, strongly suggests that the fiduciary duty to treat beneficiaries impartially will have only limited impact on the QTIP election, regardless of the courts' interpretation of the testator's intentions. With the exception of the *Warms* adjustment,[219] both elections have been unfettered by the fiduciary duty to treat beneficiaries impartially. Substantial authority exists for the proposition that the executor whose election to deduct administration expenses for income tax purposes shifts the interests of the marital and nonmarital

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powers" from "discretionary dispositive powers"); Dobris, *supra* note 199, at 286-87 & n.102, 300 n.180 (same). *See generally* Halbach, *Problems of Discretion in Discretionary Trusts*, 61 COLUM. L. REV. 1425 (1961).

215. *See* Dobris, *supra* note 199, at 284-86.

216. *See, e.g.*, Costabadie v. Costabadie, 6 Hare 410 (1847) (court may require only "honest and reasonable exercise" of trustee's discretion over payment of income); Tabor v. Brooks, 10 Ch. D. 273 (1878) (judicial interference with trustee's exercise of discretion over payment of income available only where "*mala fides*" is shown); Boston Safe Deposit & Trust Co. v. Johnson, 326 Mass. 664, 665, 96 N.E.2d 155, 157 (1951) (because there was "no contention that the trustees acted in bad faith, or arbitrarily or capriciously," court refused to interfere with trustee's exercise of discretion over payment of income and principal). The rule generally is stated that the trustee must not abuse his discretion. *See* RESTATEMENT, *supra* note 148, § 187 & comment e; 3 A. SCOTT, *supra* note 147, § 187 (citing numerous cases).

217. *See, e.g.*, *In re* Johnson's Estate, 187 Wash. 552, 60 P.2d 271 (1936); BOGERT, *supra* note 147, § 12; 1 A. SCOTT, *supra* note 147, § 6; UNIFORM PROBATE CODE § 3-703(a) (West 1982); Dobris, *supra* note 149, at 107 n.32; Taggart, *supra* note 149, at 396.

218. *See* UNIFORM PROBATE CODE § 3-703(a) (West 1982) ("A personal representative is under a duty to settle and distribute the estate of decedent in accordance with the terms of any probated and effective will . . . ."). For other distinctions between trustees and executors, see Estate of Beach, 15 Cal. 3d 623, 638, 541 P.2d 994, 1003, 125 Cal. Rptr. 570, 579 (1975), *cert. denied sub nom.* Edwards v. Superior Court, 434 U.S. 1046 (1978); Note, *Executor Distinguished from Trustee*, 52 MARQ. L. REV. 303 (1968). *See also* RESTATEMENT, *supra* note 148, § 6 ("An executorship . . . is not a trust.") & comments a, b.

219. *In re* Warms' Estate, 140 N.Y.S.2d 169 (Sur. Ct. 1955). *See supra* note 207 and accompanying text.

shares does not thereby fail to treat beneficiaries impartially.[220] Although no judicial authority speaks directly to the issue,[221] the few statutes that apply and several commentators agree that the executor does not fail to treat beneficiaries impartially by making the alternate valuation election.[222] Thus, even when tax elections are exercised by the executors of testators who have neither expressly nor impliedly authorized these elections, the executors are largely free of the duty of impartiality. Since the QTIP election is possible only if the testator chooses a certain type of marital bequest, it is even clearer that the QTIP election should not be subject to the fiduciary duty to treat beneficiaries impartially. Moreover, because the executor can minimize taxes on the current estate only by making the QTIP election, there is an important reason to allow him to do so.[223] Prior to the enactment of ERTA, Professor Dobris noted:

> Currently, no situation generally arising in fiduciary administration requires a court to approve a large tax savings obtainable only by unfair action which in turn could only be made fair by a very complicated equitable adjustment. Perhaps a court could legitimately allow such action to go unadjusted in order to save taxes.[224]

The QTIP election will occur frequently.[225] Large amounts of taxes can be saved by it (at least temporarily),[226] and "correction" would be very complicated.[227] Courts facing the QTIP election, therefore, may imply in law[228] a remission of the fiduciary duty of impartiality.[229]

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220. *See supra* note 211.

221. *In re* McTarnahan's Estate, 27 Misc. 2d 13, 202 N.Y.S.2d 618 (Sur. Ct. 1960), approved an account of an executor whose exercise of the alternate valuation election decreased the marital share. The surviving spouse, however, did not contest the accounting, and the opinion did not expressly consider the issue.

222. *See* MD. EST. & TRUSTS CODE ANN. § 11-106(b)(2) (1974); MICH. STAT. ANN. § 27.5829(2) (Callaghan 1980); N.Y. EST. POWERS & TRUSTS LAW § 11-1.2(b)(1)(B) (McKinney Supp. 1982-83); J. PRICE, *supra* note 6, at 724-25; Dobris, *supra* note 199, at 305-06; Moore, *supra* note 199, ¶ 1903; Moore, *Conflicting Interests*, *supra* note 6, ¶ 605.3; *cf.* CONN. GEN. STAT. ANN. § 45-100e(35)(A) (West Supp. 1983-84) (statute must be incorporated by reference in dispositive document). *But see* Midonick, *Trial Tactics*, 16 REAL PROP., PROB. & TR. J. 725, 731 (1981) (Surrogate of New York County suggesting equitable adjustment after alternate valuation election); Taggart, *supra* note 149, at 247 (suggesting that the New York statute does not preclude an equitable adjustment where date-of-death value is elected).

223. *See* Copley v. Copley, 126 Cal. App. 3d 248, 178 Cal. Rptr. 842 (Ct. App. 1981) (approving fiduciary conduct later determined to have been unfair to certain beneficiaries, because such conduct minimized estate taxes).

224. Dobris, *supra* note 199, at 288.

225. *See supra* note 6 and accompanying text.

226. *See supra* text accompanying note 158.

227. Unknowables, such as the rate the surviving spouse will deplete QTIP income and any principal that may be available to her, the date of death of the surviving spouse, and the total return (income and growth) available from the combined estates' assets during the life of the surviving spouse, are involved in determining whether prepayment of the estate tax should be undertaken. *See supra* notes 82-141 and accompanying text. The necessarily multifaceted analysis, in which so many of the factors are interrelated, might prove exceedingly difficult for the courts. *See generally* Fuller, *The Forms and Limits of Adjudication*, 92 HARV. L. REV. 353, 394-404 (1978).

228. *See* Dobris, *supra* note 199, at 287.

229. The execution of a will that enabled the executor to avoid estate taxes entirely might be read as evidence of an intention that taxes be minimized at the testator's death. *Cf.* Estate of Colp, N.Y.L.J., Jan. 20, 1976, at 8, cols. 2, 3 (Sur. Ct. 1976) (deriving such an intention from a maximum marital clause); Browne, *supra* note 149, at 1252 (same); Moore, *supra* note 199, ¶ 1902 (same). If

A final reason exists to exempt the QTIP election from the duty of impartiality. Because the fiduciary would be required either to make a partial QTIP election or, in the event of a full election, to make an equitable adjustment from the income interest to the remainder interest, imposition of the duty would affect adversely the interests of beneficiaries the courts often presume the testator favored. In either case, the surviving spouse, often presumed to be the testator's primary beneficiary,[230] would be affected adversely. By the same token, the interest of the income beneficiary, often presumed to occupy a similarly special place in the testator's heart,[231] would be decreased. Since the surviving spouse always is the income beneficiary of a QTIP trust, the two presumptions coincide, allowing a court to conclude that a full QTIP election does not implicate the duty of impartiality.[232]

The theory that the QTIP election can be made with little consideration of the fiduciary duty to treat beneficiaries impartially depends upon a presently unavailable judicial interpretation. As a result, unless the dispositive document contains language remitting the fiduciary duty to treat beneficiaries impartially,[233] the draftsman who relies on the executor to make the QTIP election to achieve post-mortem flexibility runs a substantial risk that the fiduciary will refuse to elect other than full deferral.[234] Even if the fiduciary does elect to make a partial election, the surviving spouse, whose interest is decreased thereby, may wish to litigate the propriety of the fiduciary's conduct if the fiduciary has not obtained the surviving spouse's consent or judicial approval of his proposed conduct. In short, full QTIP elections will be the invariable rule.[235]

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so, it would be even easier for a court to forego requiring a complicated adjustment to "correct" an election that minimized taxes.

230. *See, e.g.,* Delaware Trust Co. v. Bradford, 30 Del. Ch. 277, 282, 59 A.2d 212, 214 (Del. Ch. 1948).

231. *See* BOGERT, *supra* note 147, §§ 802, 824.

232. On the other hand, the coincidence of such presumptions could influence a court to require an equitable adjustment in favor of the surviving spouse in the event of a partial QTIP election. The opposite conclusion is reached *infra* notes 244-46 and accompanying text.

233. *See infra* text accompanying notes 294-300.

234. When the propriety of a particular course of action is in doubt, the fiduciary often opts for the alternative that results in retention of the larger amount of trust property. Continued commissions aside, the reason for doing so is clear. If a court later deems the fiduciary's conduct improper, the fiduciary who has taken the approach that augmented the trust assets simply will be required to pay, out of trust property already in hand, the portion that should have been paid earlier. The fiduciary who later is determined improperly to have decreased the size of the trust property, however, is surcharged. The surcharged fiduciary's right to recover the trust property improperly paid may be worthless or unattractive and, in the usual case, will be expensive to exercise. *See* Halbach, *supra* note 214, at 1457 (discussing fiduciary's decision whether to make distributions under discretionary trust). Thus, if the fiduciary's choice is whether to pay an optional tax, which certainly will not be recoverable in the event that a court later determines that the tax was paid improperly, the overwhelming temptation will be to elect full deferral, pay no tax, and thereby maximize the estate.

The corporate fiduciary, highly risk averse and almost always counselled by lawyers specializing in the field of estate planning, is even more likely to take the conservative course. Thus, reliance on a corporate executor to exercise the QTIP election to achieve post-mortem flexibility may be particularly unwise. *See infra* note 235.

235. At a seminar titled "1983 Estate Planning and Drafting Workshop for Attorneys" presented on May 18, 1983, in Tucson, Arizona, a representative of one of the nation's largest trust

2. Are Equitable Adjustments Necessary?

Certain inequities between estate beneficiaries can be adjusted by the executor or by a court if tax-minimizing conduct has augmented the estate.[236] If an executor chooses to minimize the estate's overall tax burden by deducting administration expenses for income, rather than estate tax purposes, the unfairness of shifting to the income beneficiaries the tax benefits of deductions obtained at the expense of principal can be corrected by charging the amount of additional estate tax to income.[237] Therefore, in the case of a full QTIP election, an equitable adjustment between the surviving spouse's interest and that of the QTIP remaindermen is possible. Given the number and complexity of factors involved in determining whether the QTIP remaindermen's interests actually will be harmed, however, both the propriety and the amount of this adjustment are difficult issues.

In *Third National Bank & Trust Co. v. Campbell*[238] the Massachusetts Supreme Judicial Court was asked to decide whether income should reimburse principal for capital gains tax incurred because of a reduction in basis caused by income's receipt of cash dividends that were treated as a return of capital by the Internal Revenue Code. The court concluded that reimbursement was not necessary and rejected the suggestion that trustees receiving such distributions should create reserves to reimburse principal for the capital gains tax eventually incurred.

> [It would be impractical to withhold a reserve] equal to the estimated future capital gains tax on that portion of the dividend which represents a tax exempt return of capital, in order to provide for the eventuality that at some time in the future the shares producing the dividend will be sold at a profit . . . . The shares may never be sold during the life of the trust or may even be sold at a loss. Any capital gain in fact realized may be offset by capital losses on other trust investments or by a carry over capital loss . . . . The tax laws or the rates of taxation on capital gains may change after the dividend is paid, thus confusing any system of reserving for future capital gains taxes.[239]

In short, one of the principal reasons for the court's holding that no adjustment was required was that the amount of future capital gains tax was unknowable.[240] An equitable adjustment requiring the surviving spouse's

companies stated that its "QTIP Committee" had elected full deferral in every estate considered to that date.

236. *See* Dobris, *supra* note 149, at 113-16; Dobris, *supra* note 199. *See generally* Carrico & Bondurant, *supra* note 149; Taggart, *supra* note 149.

237. *See supra* note 207. On the other hand, those courts and legislatures that have considered whether the marital share should reimburse the nonmarital share in the amount of the "swing" caused by the executor's I.R.C. § 642(g) (1982) election have rejected the adjustment almost unanimously. *See supra* note 211.

238. 336 Mass. 352, 145 N.E.2d 703 (1957).

239. *Id.* at 356-57, 145 N.E.2d at 706. *See also In re* Estate of Simmons, 30 Misc. 2d 1022, 220 N.Y.S.2d 515 (Sur. Ct. 1961).

240. In an entirely different setting, courts repeatedly have refused to consider potential tax liabilities. In California, courts may not take potential capital gains tax liabilities into account in

income interest to reimburse the QTIP remaindermen's principal interest for the possibility of increased estate taxes at the surviving spouse's death necessarily seeks to compensate for future taxes. Therefore, the increase in those taxes is unknowable. Moreover, it may be that no increase ever will occur. Thus, an equitable adjustment from income to principal is unlikely.[241]

An executor's decision to reimburse principal from the surviving spouse's income interest may be inappropriate for yet another reason. This reimbursement could disqualify at least a portion of the QTIP from the marital deduction,[242] because all income from the QTIP must be paid to the surviving spouse to qualify for the marital deduction.[243] Thus, adjustment in favor of the QTIP remaindermen again seems unlikely.

If an executor depletes the estate to benefit a particular beneficiary, no readily apparent fund is available for equitably "adjusting" the beneficiaries' interests.[244] Therefore, equitable adjustments seem conceptually inappropriate in the case of a partial QTIP election when estate tax is incurred voluntarily.[245] Only after the death of the surviving spouse, when another round of estate taxes will be paid, can principal possibly exceed the level it would have been if no taxes had been paid at the death of the first spouse to die.

Requiring the remaindermen to contribute the amount of prepaid estate taxes to the trust in an effort to make whole the surviving spouse's income interest is not a realistic possibility. First, the remaindermen would be required to make this reimbursement out of their funds to secure a future benefit they might never receive. The remainder might be contingent, or the trust might be depleted prior to termination. Second, even if reimbursement by the remaindermen were practical, reimbursement would tend to defeat the major

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dividing marital property following divorce, unless the tax liability is "immediate and specific." *E.g., In re* Marriage of Epstein, 24 Cal. 3d 76, 154 Cal. Rptr. 413, 592 P.2d 1165 (1979); *In re* Marriage of Fonstein, 17 Cal. 3d 738, 131 Cal. Rptr. 873, 552 P.2d 1169 (1976); Weinberg v. Weinberg, 67 Cal. 2d 557, 63 Cal. Rptr. 13, 432 P.2d 709 (1967).

241. *See* Moore, *Conflicting Interests, supra* note 6, ¶ 603.5. *Cf.* Carrico & Bondurant, *supra* note 149, at 581 (rejecting adjustment when "many factors" must enter into fiduciary's decision). MICH. STAT. ANN. § 27.5829(2) (Callaghan 1980) appears to bar such an adjustment.

242. *See* Joint Report, *supra* note 8, at 13. *See also* Moore, *supra* note 199, ¶ 1903 (pre-ERTA); Taggart, *supra* note 149, at 245 (pre-ERTA). *But cf.* Moore, *Conflicting Interests, supra* note 6, ¶ 603.5 (no loss of marital deduction if adjustment required under local law).

243. *See* I.R.C. § 2056(b)(7)(B)(ii)(I) (1982).

244. *Cf.* Dobris, *supra* note 149, at 112-13 n.61 (suggesting that court "might use a fiduciary's private funds to accomplish a fiduciary adjustment if the beneficiary who received a windfall squandered it and had no other funds to allow the adjustment to be made").

245. As has been suggested above, the appropriate judicial response to such fiduciary conduct is surcharge for breach of the fiduciary duty to minimize taxes. *See supra* notes 183-99 and accompanying text.

Moore, *supra* note 199, ¶ 1903, suggests "equitable adjustments" in numerous situations, including when the executor elects a higher alternate valuation to achieve "subsequent income tax savings" to estate beneficiaries who do not bear the increased estate tax. Moore, however, merely may be referring to the possibility that, as a precondition to engaging in estate-depleting activity, the executor will obtain reimbursement for the amount of depletion from the person to be benefited. If so, no actual estate depletion will occur and suitable funds will be available for making true equitable adjustments of the beneficiaries' interests. Estate of Rappaport, 121 Misc. 2d 447, 467 N.Y.S.2d 814 (Sur. Ct. 1983), authorized an I.R.C. § 642(g) election that failed to minimize an estate's overall taxes only when the benefited parties paid into escrow the amount by which taxes would be increased.

purpose of prepaying the estate tax. Instead of reducing the potential gross estate of the surviving spouse, reimbursement would tend to increase it. Thus, neither an executor nor a court is likely to view an equitable adjustment as appropriate in the case of a tax-generating partial QTIP election.[246]

3. Shifting State Death Taxes to the Beneficiaries of the Surviving Spouse

Section 2207A(a)(1) of the Code gives the estate of the surviving spouse a right to recover from the recipients of the QTIP the federal estate tax incurred by inclusion of the QTIP in the survivor's gross estate. That section, however, provides no right to recover state death taxes similarly incurred. Therefore, one of the effects of the QTIP election is a shift of the state death taxes on the first spouse's estate to the beneficiaries of the survivor. A strong argument can be made that this shift invokes the fiduciary duty of impartiality and requires an equitable adjustment. Like the shift in deductions giving rise to the *Warms* adjustment,[247] an executor's unilateral act shifts tax consequences from the beneficiaries of the interest that incurred those consequences. Consequently, some sort of compensation to the beneficiaries of the surviving spouse may be required. If the *Warms* pattern were followed, the beneficiaries of the surviving spouse would be entitled to reimbursement for the state death taxes on the surviving spouse's estate incurred by inclusion of the QTIP in either the federal or the state tax base, or both.[248]

On the other hand, the problem may disappear whenever there is a surviving spouse. Until the death of the surviving spouse, she has neither heirs nor beneficiaries.[249] Thus, the "interests" of such "heirs" and "beneficiaries" are represented exclusively by the surviving spouse. Since the surviving spouse is benefited by a full QTIP election,[250] no one is in a position to complain about the shift of state death taxes.[251] Moreover, the surviving spouse frequently serves as executor[252] and thus will personally make the election. If the surviving spouse dies before the exercise of the QTIP election, however, the executor will be unable to defend the shift of state death taxes on the basis of a benefit to the surviving spouse, and an adjustment almost certainly will be

246. *See* Joint Report, *supra* note 8, at 13. *See also* Dobris, *supra* note 199, at 280, 330 ("Equitable adjustments are not required . . . when they are hard to make . . . or too conjectural as to injury or remedy."). MICH. STAT. ANN. § 27.5829(2) (Callaghan 1980) appears to bar such an adjustment.

247. *See supra* note 207 and accompanying text.

248. Reference to inclusion in the federal estate tax base is necessary to measure the full extent by which state death taxes are increased. In sponge-tax states, the state death tax increases as the federal state death tax credit, which is based on the federal taxable estate, increases. *See generally supra* note 68.

249. *See* Morsman v. Commissioner, 90 F.2d 18, 26 (8th Cir.), *cert. denied*, 302 U.S. 701 (1937); Duffield v. Duffield, 268 Ill. 29, 35, 108 N.E. 673, 675 (1915); Avon State Bank v. Commercial & Sav. Bank, 49 S.D. 575, 579, 207 N.W. 654, 656 (1926).

250. *See supra* text accompanying notes 96-99.

251. Is a person whose property may bear an increased tax after her death harmed thereby? If so, when the probable increase in income and principal made available to the surviving spouse by a QTIP election is less than the probable increase in state taxes at her death, she might be viewed as having been harmed by the QTIP election's shift in state death taxes.

252. *See infra* note 255 and accompanying text.

appropriate.[253]

C. *The Fiduciary Duty of Loyalty*

An additional obstacle to the fiduciary's exercise of the QTIP election is created by the strong possibility that the fiduciary will have a conflict of interest in making the election.[254] Typically, the surviving spouse will be the executor.[255] The QTIP election allows such a fiduciary to favor herself over other beneficiaries.[256] In choosing to elect QTIP status for the entire amount of the decedent's estate, less only the credit-shelter amount, a fiduciary not only maximizes the surviving spouse's interest but also may decrease substantially the amount that the QTIP remaindermen eventually will receive at the surviving spouse's death.[257] Therefore, a surviving spouse serving as executor has a personal financial interest in the election. Although the testator usually will have desired a significant portion, if not all, of his estate to qualify for the marital deduction, the surviving spouse conceivably could be disqualified from making the QTIP election because of this conflict of interest.

A testator, however, can permit the executor to do what otherwise would constitute a breach of the duty of loyalty by express provision in his will.[258] In *Rosencrans v. Fry*[259] the testator left corporate shares, which represented the controlling interest in his business, in trust for the benefit of his wife.[260] In his will he designated his wife and Fry, the manager of the corporation, as cotrustees.[261] The testator also granted Fry the right to purchase the trust shares at par value.[262] The New Jersey Supreme Court permitted Fry to purchase the

253. If the executor of the first spouse to die elects full deferral in such a case, the executor also may have failed to minimize taxes (because of the surviving spouse's estate's immediate right of reimbursement against the estate of the first spouse to die). *See supra* notes 82-88 and accompanying text. If so, the executor should be surcharged for the amount by which the federal estate tax and, assuming that the adjustment suggested in the text is required, the state death taxes payable by the estate of the first spouse to die are increased as a result of failing to "prepay" enough tax to arrive at the lowest tax result. *See generally supra* notes 183-99 and accompanying text.

254. "The most fundamental duty owed by the trustee to the beneficiaries of the trust is the duty of loyalty." 2 A. SCOTT, *supra* note 147, § 170. *See also* BOGERT, *supra* note 147, § 543; RESTATEMENT, *supra* note 148, § 170(1) & comment a; Scott, *The Trustee's Duty of Loyalty*, 49 HARV. L. REV. 521 (1936).

255. An informal survey taken in 1982 at a meeting of the American College of Probate Counsel indicated that attorneys' spouses were named as executors in the attorneys' own wills "a very high percentage of the time." Lombard & Gother, *Choosing Your Executor and Trustee*, 8 PROB. NOTES 246, 257 (1983). The range was from 81% of lawyers surveyed who were from the West to 58% of lawyers surveyed who were from the Midwest. *Id.* at 259. If the surviving spouse is not the executor, one or more of the testator's children usually will be the executor. As remaindermen under a QTIP trust, children would have similar conflicts of interest.

256. *See* Brackney, *supra* note 8, at 29; Joint Report, *supra* note 8, at 9-10; Kurtz, *supra* note 8, at 643-44; Moore, *New Marital Deduction*, *supra* note 6, ¶ 904.

257. *See supra* notes 64-74 and accompanying text.

258. *See* BOGERT, *supra* note 147, § 543(A); 2 A. SCOTT, *supra* note 147, § 170.9; RESTATEMENT, *supra* note 148, § 170, comment t; Scott, *supra* note 254, at 536-37, 542; UNIFORM PROBATE CODE § 3-713(1) (West 1982).

259. 12 N.J. 88, 95 A.2d 905 (1953).

260. *Id.* at 92-93, 95 A.2d at 907-08.

261. *Id.* at 93, 95 A.2d at 908.

262. *Id.*

shares from the trust over Mrs. Rosencrans' objections.[263] The court noted that the "conflict of interest, if any, . . . was created not by Fry but by the testator, . . . by whose will he was named co-trustee."[264] The court was unwilling to deny Fry "that which the will expressly gave him, and if, under the circumstances, the trustee acted fairly and in good faith, he is not to be penalized."[265]

There also are instances in which courts, in the absence of express authority under the will, have permitted behavior that otherwise would have been impermissible self-dealing.[266] In *Turnbull v. Pomeroy*[267] the testator directed his testamentary trustee to continue the testator's manufacturing business "in the same general manner said business is now carried on."[268] During his lifetime, the testator regularly had consigned "about half" of his business' output to the firm of the person he designated as trustee.[269] The Massachusetts Supreme Judicial Court, in a opinion by Justice Holmes, permitted the trustee to continue the testator's practice of consigning a portion of the business' output to the trustee's own firm, despite the fact that he thereby realized "a considerable sum" in commissions.[270] The court reasoned that the testator's authorization to continue the business evidenced his expectation that his past business dealings with the consignee-trustee would continue.[271] Indeed, if a testator's will requires a particular activity that necessarily affects the personal financial interests of the person chosen to act as fiduciary, the required actions should be permitted, in the absence of abuse,[272] just as if the testator had authorized expressly the self-dealing.[273]

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263. *Id.* at 102-04, 95 A.2d at 913.

264. *Id.* at 102, 95 A.2d at 913.

265. *Id.* at 103, 95 A.2d at 913. *See also* Bloodworth v. Bloodworth, 224 Ga. 717, 164 S.E.2d 823 (1968).

266. *See, e.g.*, Copley v. Copley, 126 Cal. App. 3d 248, 272-75, 178 Cal. Rptr. 842, 857-59 (Ct. App. 1981); Goldman v. Rubin, 292 Md. 693, 711-14, 441 A.2d 713, 724-25 (1982). *See also* 2 A. SCOTT, *supra* note 147, § 170.9; Ledwith, *supra* note 199, at 22-23.

267. 140 Mass. 117, 3 N.E. 15 (1885).

268. *Id.* at 117-18, 3 N.E. at 16.

269. *Id.* at 118, 3 N.E. at 16.

270. *Id.* at 117, 3 N.E. at 16.

271. *Id.* at 119, 3 N.E. at 17. *See also* Vredenburgh v. Jones, 349 A.2d 22 (Del. Ch. 1975). In *Vredenburgh*, decedent's will authorized her executor to set up a corporation for the development of various mining interests. *Id.* at 27-28. The court dismissed objections to the executor's payment of a salary to himself as officer and director of the resulting corporation. *Id.* at 44. The court reasoned that there was "no thought that if [the executor] formed a corporation he was to run it in his capacity as executor and be compensated solely through his commissions on the estate." *Id.*

272. In *In re* Flagg's Estate, 365 Pa. 82, 73 A.2d 411 (1950), the court permitted redemption of corporate shares by cotrustees, one of whom was the controlling shareholder. The court emphasized that the testator's will authorized the trustee-shareholder to buy these shares and that diversification of the trust was necessary. *Id.* at 89-91, 73 A.2d at 415-16. The court then reasoned that "where the power, indeed duty, to engage in self-dealing is necessarily implied in the terms of the testator's will the valid exercise of that power will not be set aside by this court." *Id.* at 92, 73 A.2d at 416. *Cf.* Boston Safe Deposit & Trust Co. v. Lewis, 317 Mass. 137, 141, 57 N.E.2d 638, 640-41 (1944) ("[W]here the method selected by a testator for the accomplishment of the purpose and object of the trust cannot be adopted by a trustee without dealing with himself individually, it may be fairly assumed that such dealing was contemplated by the testator.").

273. *See supra* note 258 and accompanying text.

Can a surviving spouse chosen by the testator as his executor exercise the QTIP election as required by the terms of the testator's will and the Code? If so, must the surviving spouse exercise it against her own financial interest? Some authority suggests that the surviving spouse, as fiduciary, must take the least personally advantageous path.[274] Would not such a rule render superfluous the testator's intricate planning and drafting for a marital deduction? Certainly a testator who executes a will setting forth marital and credit-shelter shares intends that in at least some circumstances some portion of his estate should qualify for the marital deduction. This intent would be flouted if the surviving spouse, as fiduciary, was unable to qualify any portion of the estate for the marital deduction.[275] Such a rule could clash with the fiduciary duty to minimize taxes, which generally requires the QTIP election with respect to any property in excess of the unified credit equivalent.[276] A rule requiring the surviving spouse to exercise the QTIP election only to benefit the estate's other beneficiaries occasionally would require the opposite course of conduct.[277]

Other authority argues, by analogy, that the surviving spouse should not be allowed to exercise the QTIP election at all. A small but growing body of law indicates that a trustee-beneficiary may not exercise any discretion to pay income or principal to himself.[278] In *Armington v. Meyer*[279] the Supreme

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274. *See* Estate of Rappaport, 121 Misc. 2d 447, 450, 467 N.Y.S.2d 814, 816-17 (Sur. Ct. 1983) ("The . . . duty to refrain from self-dealing acts . . . should bar a fiduciary who is also a beneficiary from making a tax election unfairly favoring his beneficial interest over that of another beneficiary."); Estate of Colp, N.Y.L.J., Jan. 20, 1976, at 8, cols. 2-3 (Sur. Ct. 1976) (dictum) ("It is incumbent upon the executors to resolve this issue in such manner as not to benefit one or the other of them at the expense of [the] life beneficiaries for they do so at their peril."); *In re* Warm's Estate, 140 N.Y.S.2d 169, 171 (Sur. Ct. 1955) ("The tax option [—the election, under I.R.C. § 642(g), to deduct administration expenses for income tax purposes—] which results in a benefit to the income beneficiary, especially where she is coexecutrix, should not be exercised to the detriment of the remaindermen."). *But see* Will of Raible, N.Y.L.J., May 20, 1977, at 14, col. 1 (Sur. Ct. 1977) (it would "not be imprudent" for widow, serving as coexecutor with "an independent fiduciary," to exercise the alternate valuation election to increase her marital share); *In re* Estate of Fiedler, 55 N.J. Super. 500, 511-12, 151 A.2d 201, 207 (App. Div. 1959) ("True, [the executor] must be held to a high degree of accountability for his actions, but this is not to say that he must consider his interest as a beneficiary less than the interest of [other beneficiaries] because of his appointment as executor.").

Judicial language frequently has admonished executors to subordinate personal interests in dealing with their estates. For example, in Herman's Estate, 90 Pa. Super. 512 (1927), the court stated: "Where the personal interests of an executor or other trustee are in conflict with the general good of the estate the law will always require him to adopt that course which will benefit the estate rather than that which will result to his own advantage." *Id.* at 514. In the typical self-dealing case, the executor's interests truly are opposed to those of the estate as a whole. In *Herman's Estate*, for example, the executor caused the estate to pay for painting buildings that passed to him and his heirs. *Id.* Thus, the expense depleted the estate and was disallowed. *Id.* In the case of tax elections, however, the estate as a whole may be benefited by an election that favors the executor. A rule that always required the executor to make tax elections in his own personal worst interest therefore sometimes would require payment of unnecessary taxes. In fact, the Surrogate who wrote *Colp* has reconsidered this position. *See supra* note 185.

275. *See* Joint Report, *supra* note 8, at 9.

276. *See supra* notes 183-99 and accompanying text.

277. *See supra* notes 64-74 and accompanying text. For a case that permitted minimization of estate taxes despite an administrator-trustee's conflict of interest, see Copley v. Copley, 126 Cal. App. 3d 248, 272-75, 178 Cal. Rptr. 842, 857-59 (1981).

278. *See* Garfield v. United States, 80-2 U.S. Tax Cas. (CCH) ¶ 13,381 (D. Mass. 1980); Rogers v. Rogers, 111 N.Y. 228, 18 N.E. 636 (1888). *Cf.* Dana v. Gring, 374 Mass. 109, 371 N.E.2d 755 (1977) (construing will to deny the trustee-beneficiary the power to distribute principal to herself).

Court of Rhode Island held that when the testator had granted cotrustees discretion to pay income to a group that included the trustees, court approval was necessary for all payments of income by the cotrustees to themselves.[280] Statutes in Indiana,[281] New York,[282] North Carolina,[283] and Wisconsin[284] similarly prohibit the interested trustee-beneficiary from benefiting himself. This trend, however, if it is a trend, admittedly is a minority position.[285] In any event, courts have extended this view only to trustees. One reason why the view is more applicable to trustees than to executors is that it also responds to the beneficiary-trustee's problem of merger of title.[286] If a sole trustee who owns legal title to the trust property acquires the entire equitable interest in the trust, the titles merge and the trust terminates.[287] Thus, the issue whether merger should apply if a trustee has discretion to pay principal to himself arises. In fact, several of the cases supporting the proposition that a trustee-beneficiary may not exercise his discretion over income or principal in his own favor considered this issue.[288] Since the primary function of an executor is to administer an estate rather than to hold property for another, merger is not a problem for an executor. Thus, an estate's sole beneficiary can act as its sole executor.[289] Moreover, the *Armington* view generally has been limited to situations involving trustee discretion to pay income or principal to himself.[290] Exercise of the QTIP election allows a surviving spouse acting as executor only the opportunity to avoid depletion of the fund from which his or her income will be derived. Conferring the right to exercise the QTIP election upon an interested fiduciary is therefore much less dangerous than conferring discretion to pay income or principal.

But cf. In re Estate of Seidman, 58 A.D.2d 72, 75-76, 395 N.Y.S.2d 674, 677 (1977). In re *Estate of Seidman* directed the Surrogate's Court to appoint a cotrustee to exercise discretion over payment of principal to the sole trustee-beneficiary. The court, however, noted that although in New York a trustee-beneficiary is "subject to a *statutory* provision that a power, vested in a person in his capacity as trustee of an express trust to distribute principal to himself may not be exercised by him," the "*fiduciary* obligation" of such a trustee-beneficiary requires only that he "confine" his invasions "within reasonable limits." *Id.* at 75-76, 395 N.Y.S.2d at 677 (emphasis added).

279. 103 R.I. 211, 236 A.2d 450 (1967).

280. *Id.* at 222-23, 236 A.2d at 456-57.

281. IND. CODE ANN. § 30-4-3-5 (Burns 1972).

282. N.Y. EST. POWERS & TRUSTS LAW § 10-10.1 (McKinney 1967).

283. N.C. GEN. STAT. § 32-34 (1976).

284. WIS. STAT. ANN. § 701.19(10) (West 1981).

285. *See* Armington v. Meyer, 103 R.I. 211, 221, 236 A.2d 450, 456 (1967); *see generally* BOGERT, *supra* note 147, § 129.

286. *See generally* BOGERT, *supra* note 147, § 129.

287. *See* BOGERT, *supra* note 147, § 129; RESTATEMENT, *supra* note 148, §§ 99(5), 115(5); 2 A. SCOTT, *supra* note 147, § 99.

288. *E.g.*, Rogers v. Rogers, 111 N.Y. 228, 237, 18 N.E. 636, 638 (1888); *In re* Estate of Seidman, 58 A.D.2d 72, 74, 395 N.Y.S.2d 674, 676 (1977).

289. *See* T. ATKINSON, HANDBOOK OF THE LAW OF WILLS 611 (2d ed. 1953).

290. Each of the statutes cited *supra* notes 281-84 applies only to trusts and trustees. Even if the statutes were construed to include executors, only that of Indiana seems broad enough to cover a QTIP election. IND. CODE ANN. § 30-4-3-5 (Burns 1972) provides: "If the duty of the trustee in the exercise of any power conflicts with his individual interest or his interest as trustee of another trust, the power may be exercised only with court authorization." The others apply only to payment of income or principal or to allocation of receipts and expenses between income and principal.

Professor Scott, summarizing the duty of loyalty, wrote that a fiduciary was "not permitted to place himself in a position where it would be for his own benefit to violate his duty to the beneficiaries."[291] If a testator and the Code require an executor to make the QTIP election and the testator nevertheless designates his surviving spouse as executor, can the surviving spouse fairly be viewed as having "placed" herself in a position to benefit herself? Given the testator's clear intentions, can the executor owe the other beneficiaries a duty not to make the election? A case that is more analogous and persuasive strongly suggests that the surviving spouse as executor is free to exercise the QTIP election in accordance with her other fiduciary duties, notwithstanding her self-interest. *In re Veith's Estate*[292] involved another election imposed on executors by the Code. The court held that an income beneficiary's personal financial interest in her election to deduct administration expenses for income tax purposes did not bar her from so electing.[293] This holding is consistent with the premise of *Rosencrans* and *Turnbull*; if the testator designates as a fiduciary one known to have an unavoidable conflicting interest with respect to an action required of the fiduciary, in the absence of abuse, no self-dealing can occur.

D. *Remission of Fiduciary Duties*

Regardless how the courts ultimately resolve these issues of fiduciary conduct, each presently involves substantial uncertainty. Estate planning that invites litigation has failed miserably, regardless of outcome.[294] The use of an estate planning opportunity with QTIP's appeal, however, cannot be delayed until the judicial treatment of a fiduciary QTIP election is clear. Because a testator may authorize his fiduciary to do that which the fiduciary otherwise would not be permitted to do,[295] language expressly dealing with each of these

291. 2 A. SCOTT, *supra* note 147, § 170.

292. 26 Fla. Supp. 145 (Judges' Ct. 1965).

293. *Id.* at 150.

294. *Cf.* Langbein, *Substantial Compliance with the Wills Act*, 88 HARV. L. REV. 489, 524 (1975) ("The counselor's job is to prevent litigation.").

295. *See supra* notes 258-65 and accompanying text. Professor Scott distinguishes "a provision in the trust instrument which permits the trustee to do acts which would not otherwise be permissible" from "a provision which merely relieves the trustee from liability if he does them." 3 A. SCOTT, *supra* note 147, § 222.1. *See also* Moore, *A Rationalization of Trust Surcharge Cases*, 96 U. PA. L. REV. 647, 674-75 (1948). The former permits a fiduciary to do, without engaging in a breach of trust, that which the fiduciary otherwise would not be permitted to do. The latter, on the other hand, merely relieves a fiduciary of liability for doing that which is admittedly a breach of trust. In practice, the distinction is not always easy to make. See generally Report of the Committee on Trust Administration and Accounting, *Exculpatory Clauses—Their Legal Significance*, 1 REAL PROP., PROB. & TR. J. 530 (1966) [hereinafter cited as Committee Report], particularly the Appendix, at 541-48, which provides a wealth of sample forms, all designated as "exculpatory clauses" but consisting not only of both types but also of combinations and blends. *See, e.g., id.* at 546, Form K2.

The language suggested in the text accompanying *infra* note 297 aims primarily at authorizing the executor to act rather than at relieving the executor of liability for acting. Regardless which category the suggested language falls into, however, it should succeed in its primary objective of avoiding executor liability for exercise of the QTIP election. If viewed as a grant of discretion to exercise the QTIP election, the provision should put the election beyond the court's review, "except to prevent an abuse." RESTATEMENT, *supra* note 148, § 187. If viewed as exculpatory, the issues should be included in every QTIP document that relies on an executor's exercise of discretion in making the QTIP election.[296] This language might take the following form:

> I hereby authorize my executor, in his sole discretion, to elect that none, any part, or all of any amount passing under this trust be treated as qualified terminable interest property for the purposes of qualifying for the marital deduction allowable in determining the federal estate tax and any state death tax on my estate, regardless of the fact that such taxes are thereby increased or that there is a change in the proportions in which various persons (including my executor) share in my estate. The decision of my executor shall be binding and conclusive upon all persons interested in my estate, and my executor shall have no liability as a result of such decision.[297]

Although effectiveness of this language cannot be guaranteed,[298] it is designed to cope with the courts' tendency to construe strictly such provisions.[299] A court, therefore, probably would respect the suggested language if asked to review fiduciary conduct in exercising the election.[300]

The suggested language purports to leave the decision whether to elect QTIP status entirely to the executor; it provides no guidance from the testator. The testator's intentions, however, are indispensable in deciding how much marital deduction is appropriate.[301] Thus, the testator's intentions should be the focus of both the executor's and any court's attention. Therefore, the testator also should apprise the executor of his wishes concerning the QTIP elec-

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provision would fall into the lap of plentiful authority enforcing such provisions. *See, e.g.*, BOGERT, *supra* note 147, § 542; RESTATEMENT, *supra* note 148, § 222(1); 3 A. SCOTT, *supra* note 147, § 222; Committee Report, *supra*, at 531; Annot., 158 A.L.R. 616 (1933). *Cf.* New England Trust Co. v. Paine, 317 Mass. 542, 550, 59 N.E.2d 263, 269 (1945) (noting that although law does not "look with special favor" upon exculpatory clauses, they nevertheless are "generally held effective").

296. *See* Joint Report, *supra* note 8, at 15-16; *Marital Deduction Problems*, *supra* note 145, at 24; Moore, *Conflicting Interests*, *supra* note 6, ¶ 603.4; Moore, *New Marital Deduction*, *supra* note 6, ¶ 904; Stewart, *supra* note 10, at 28; Suter, *Careful Drafting of Apportionment Clause Can Ensure Tax Burden Will Fall Where Client Intends*, 9 EST. PLAN. 156, 162 (1982); *Panel Discussion*, *supra* note 57, ¶ 52.01[4].

297. For other examples of language remitting fiduciary duty in the context of the QTIP election, see H. TWEED & W. PARSONS, LIFETIME AND TESTAMENTARY ESTATE PLANNING 140 (9th ed. 1983); Cornfeld, *Marital Deduction*, *supra* note 71, ¶ 1409, Form 14, ¶ 7; Covey, *supra* note 8, ¶ 110.7; Gamble, *supra* note 52, at 46-47; Keydel, *supra* note 6, at 51; Kurtz, *supra* note 8, at 643; Strauss, *supra* note 6, at 77.

298. *See, e.g.*, BOGERT, *supra* note 147, § 542 (noting judicial hostility to exculpatory clauses). *Cf.* Shinn, *Exoneration Clauses in Trust Instruments*, 42 YALE L.J. 359 (1933) (criticizing judicial enforcement of exculpatory clauses); Note, *Directory Trusts and the Exculpatory Clause*, 65 COLUM. L. REV. 138, 141 (1965) (stating that "the courts have been generally reluctant to endorse the exoneration of trustees" and "have resorted to not only extremely strict construction of exculpatory provisions, but also interpretive techniques and fictions to hold trustees answerable").

299. *See* RESTATEMENT, *supra* note 148, § 174 comment d (provisions modifying fiduciary duties); 3 A. SCOTT, *supra* note 147, § 222.2 (exculpatory provisions); Committee Report, *supra* note 295, at 540 (exculpatory provisions and provisions authorizing fiduciary action).

300. *Cf.* Estate of Rappaport, 121 Misc. 2d 447, 450, 467 N.Y.S.2d 814, 816 (Sur. Ct. 1983) (permitting failure to minimize taxes where will authorized executors to exercise tax elections regardless whether the outcome was "the most advantageous one from the point of view of my estate as an entity").

301. *See supra* notes 96-141 and accompanying text.

tion.[302] Professor Halbach has suggested the following language for a discretionary trust: "In the creation of this trust, my primary purpose is to provide for [my spouse's] welfare and happiness, and the interests of all others hereunder are subordinated to that purpose."[303] This language, drafted twenty years prior to ERTA, could be equally appropriate in the QTIP context. It notifies the executor that the surviving spouse is the testator's overwhelmingly predominant beneficiary.[304] Another alternative, drafted with the QTIP election in mind, is:

> Without limiting the foregoing discretion, it is my expectation that my executor will make said election with respect to all of any such amount unless my [spouse] dies prior to the making of such election and the combined death taxes in our two estates render such an election inappropriate.

Here, too, the executor's course of conduct is clear: although not required, full deferral is expected. In the case of simultaneous or nearly simultaneous death, however, the executor is expected to take into account the combined estate taxes. Thus, the executor is expected to optimize the QTIP remainder only if the interests of the surviving spouse—the testator's overwhelmingly predominant beneficiary—are irrelevant.

The dispositive document also could include instructions on equitable adjustments.[305] Because the appropriate size and the propriety of any such adjustment are difficult to determine[306] and because of the possibility of loss of the marital deduction,[307] this issue probably is addressed best by language prohibiting the executor from making any equitable adjustments relating to the QTIP election.[308] The following language should be effective to prohibit any equitable adjustments by the executor: "My executor shall not make any adjustment of beneficiaries' interests on account of such election, whether the election is made in full, in part, or not at all."

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302. *See* Brackney, *supra* note 8, at 29; Gutierrez, *supra*, note 8, ¶ 1404.1(A); Joint Report, *supra* note 8, at 14-15; Moore, *Conflicting Interests*, *supra* note 6, ¶ 603.4; Moore, *New Marital Deduction*, *supra* note 6, ¶ 904; Stewart, *supra* note 10, at 28.

On the other hand, an important advantage supposedly offered by the typical full-deferral estate plan is post-mortem flexibility. If the testator undertakes to advise the executor concerning how to make the QTIP election, the effect likely will be to restrict that flexibility.

303. Halbach, *supra* note 214, at 1455.

304. *See supra* notes 96-98 and accompanying text.

305. *See* Joint Report, *supra* note 8, at 13; Ritchie, *supra* note 146, at 38, 43; Suter, *supra* note 296, at 162.

306. *See supra* notes 236-53 and accompanying text.

307. *See supra* notes 242-43 and accompanying text.

308. *See* Moore, *Conflicting Interests*, *supra* note 6, ¶ 603.5; *Panel Discussion*, *supra* note 57, ¶ 52.04[5]. *Cf.* Carrico & Bondurant, *supra* note 149, at 555, 602 ("Most equitable adjustments probably should be expressly prohibited."); Dobris, *supra* note 149, at 141-42 n.221 (noting that "sophisticated lawyers" try to avoid equitable adjustments); Dobris, *supra* note 199, at 283, 341 (same); Ritchie, *supra* note 146, at 43 ("The calculation of the amount of the adjustment is a herculean task . . . , and most fiduciaries would prefer to have such adjustments waived.").

V. Other Adverse Tax Consequences of Relying on Fiduciary Exercise of the QTIP Election

A. Income Tax Implications

An executor can elect QTIP status only if the surviving spouse has a "qualifying income interest for life."[309] One requirement for such an interest is that the surviving spouse be "entitled to all the income from the property."[310] Many commentators have suggested that all income must continue to be payable to the surviving spouse even if the executor elects QTIP status for only a portion of the property.[311] As a result, an estate plan that relies on fiduciary exercise of the QTIP election forces all of the QTIP income to be taxed to the surviving spouse,[312] even if a partial election is made. If the surviving spouse already is in a high income tax bracket, the result may be wasteful income taxation. In any event, such an estate plan foregoes the opportunity to split income among other family members who may be in lower income tax brackets[313] or in greater need of support.[314]

B. Gift Tax Implications

1. The QTIP Election

Refusal to accept a bequest or an interest in trust generally results in imposition of the gift tax,[315] unless the refusal is in the form of a qualified disclaimer.[316] A donee usually must disclaim within nine months of the creation of the interest.[317] The QTIP election, however, need not be made within nine months of the decedent's date of death.[318] If a surviving spouse acts as executor, the possibility thus exists that she will make the QTIP election more than

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309. I.R.C. § 2056(b)(7)(B)(i)(II) (1982).

310. *Id.* § 2056(b)(7)(B)(ii)(I).

311. *See, e.g.*, J. PRICE, *supra* note 6, at 257-58; Blattmachr & Lustgarten, *Selected Considerations*, *supra* note 3, at 39, 45 n.18; Covey, *supra* note 8, ¶ 110.8; Dirkes, *How to Minimize the Tax Consequences of Shifting Beneficial Interests in Trusts*, 9 EST. PLAN. 336, 336-37 (1982); Horn, *supra* note 8, at 23, 31; McCaffrey & Kalik, *supra* note 8, at 2, col. 5; Moore, *New Marital Deduction*, *supra* note 6, ¶ 905; Shattuck, *Effective Estate Planning May Mean not Using the Unlimited Marital Deduction*, 28 TAX'N FOR ACCOUNTANTS 358, 362-63 (1982); Strauss, *supra* note 6, at 80; *Planning and Drafting for the Unlimited Marital Deduction*, 9 COMMUNITY PROP. J. 47, 51 (1982). The theory is that if the executor's failure to elect QTIP status could cause any portion of the fund to pass to a trust that did not fit the definition of a qualifying income interest under I.R.C. § 2056(b)(7)(B)(ii) (1982), the trust would fail to qualify for the exemption offered by I.R.C. § 2056(b)(7)(A)(ii) (1982) from the terminable interest rule of I.R.C. § 2056(b)(1)(A) (1982). Therefore, the entire trust would be a nondeductible terminable interest.

312. *See* I.R.C. § 652 (1982).

313. For the possibilities of income splitting through use of multiple trusts, see Morris Trusts, 51 T.C. 20 (1968), *aff'd per curiam*, 427 F.2d 1361 (9th Cir. 1970). Treas. Reg. § 1.641(a)-0(c) (1972), which requires a "substantially independent purpose" for multiple trusts created by the same person for a single beneficiary, has been held invalid in Stephenson Trust, 81 T.C. 283 (1983).

314. *See, e.g.*, J. PRICE, *supra* note 6, at 258; Halbach, *supra* note 70, at 44; Salus, *supra* note 71; Shattuck, *supra* note 311, at 362.

315. *See* I.R.C. §§ 2501(a)(1), 2511(a) (1982).

316. *See id.* § 2518.

317. *See id.* § 2518(b)(2)(A).

318. *See supra* notes 50-54 and accompanying text.

nine months after the death of the first spouse to die. Conceivably, the election then could be viewed as a taxable gift if it resulted in prepayment of estate tax and a corresponding reduction of the surviving spouse's income interest.

Authority in an analogous area is helpful. Exercise of a special power of appointment generally does not result in imposition of the gift tax.[319] The IRS, however, has taken the position that exercise of a special power by a person entitled to receive the income from the property appointed constitutes a taxable gift in the amount of the value of the income interest given up.[320] *Self v. United States*[321] is to the contrary, but the IRS has indicated that it will not follow *Self*.[322]

A surviving spouse who makes the QTIP election and thereby causes prepayment of a portion of the estate tax more than nine months after her spouse's death extinguishes her life income interest in the amount of the prepaid taxes, just as the income beneficiary extinguishes his interest when he exercises a special power of appointment. Thus, the IRS might attempt to impose a gift tax on a surviving spouse making such an election.[323] No court is likely to impose gift tax liability on a surviving spouse who depletes her income interest by using the QTIP election to cause prepayment of the estate tax.[324] Nonetheless, the possibility that the IRS will view such an exercise as a taxable gift is another disincentive for the surviving spouse serving as executor to elect other than full deferral.

2. During the Surviving Spouse's Lifetime

The entire value of a QTIP trust, not merely the value of the surviving spouse's income interest, qualifies for the marital deduction in the estate of the first spouse to die.[325] Consequently, section 2044 includes the value of the entire QTIP in the gross estate of the surviving spouse. ERTA provided a similar innovation, section 2519, to ensure that a lifetime transfer of the QTIP income interest also would subject the value of the QTIP remainder to the gift tax. Unfortunately, section 2519 as originally enacted[326] and explained in the legislative history,[327] and especially as amended by the Technical Corrections

319. *See* I.R.C. § 2514(b), (c) (1982).

320. *See* Treas. Reg. § 25.2514-1(b)(2) (1981).

321. 142 F. Supp. 939 (Ct. Cl. 1956). *Self* is criticized strongly in Note, *Special Powers of Appointment and the Gift Tax: The Impact of Self v. United States*, 3 VAL. U.L. REV. 284 (1969).

322. *See* Rev. Rul. 79-327, 1979-2 C.B. 342.

323. Presumably, the amount of such a gift would be the actuarial value of the surviving spouse's foregone income from the prepaid taxes.

324. *Cf.* Covey, *supra* note 8, ¶ 110.7 (paying tax early does not involve a taxable gift); Horn, *supra* note 8, at 31 (no taxable transfer when spouse-executor decreased marital deduction by deducting administration costs for estate tax purposes).

325. *See* I.R.C. § 2056(b)(7) (1982).

326. *Id.* § 2519(a) (amended 1983).

327. H.R. REP. No. 201, 97th Cong., 1st Sess., 161 (1981), *reprinted in* 1981-2 C.B. 352, 378; STAFF OF THE JOINT COMM. ON TAX'N, 97TH CONG., 2D SESS., GENERAL EXPLANATION OF THE ECONOMIC RECOVERY TAX ACT OF 1981 (Joint Comm. Print 1981) [hereinafter cited as JOINT COMMITTEE].

Act of 1982,[328] considers an assignment of any portion of the QTIP income interest as a taxable gift of the entire QTIP remainder by the surviving spouse.[329] It is unlikely that final regulations will correct the problem; as a result, estate planning for the surviving spouse whose only interests are in a QTIP trust will be difficult. Although full deferral deliberately stacks both spouses' property into the surviving spouse's gross estate, concurrent use of QTIP virtually locks the surviving spouse into the tax consequences. Consequently, the surviving spouse's only viable means of depleting her gross estate are disposition of income as paid and exercise of any limited right of withdrawal. Trustee discretion to invade principal on behalf of the surviving spouse may be promising in some situations, but fiduciary, personal, or institutional concerns often will prevent the trustee from invading principal to the extent necessary to meet the surviving spouse's estate planning goals, especially if the surviving spouse's intended donees differ from the QTIP remaindermen. Thus, estate planning by QTIP election largely strips the surviving spouse of the ability to plan her own estate.[330]

C. Estate Tax Implications

The value of a QTIP trust at the death of a surviving spouse will be included in her gross estate.[331] Good estate planning dictates that withdrawals and invasions of principal during the life of the surviving spouse come from the marital share to reduce the estate tax payable at the survivor's death.[332] Many commentators have expressed doubts, however, whether rights of withdrawal or powers of invasion can be limited to that portion of the marital trust for which the executor elects QTIP status.[333] If, as seems likely under the Temporary Regulations,[334] such a limitation presently is not available, princi-

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328. Technical Corrections Act of 1982, Pub. L. No. 97-448, § 104(a)(3)(A), 96 Stat. 2365, 2380 (1983) (amending I.R.C. § 2519(a) (1982)).

329. *See, e.g.*, Covey, *supra* note 89, ¶ 102; Silverman, *Technical Corrections Act Affects QTIP Property*, PROB. & PROP., Summer 1983, at 13, 14. Whatever the obvious unfairness of such an approach, it is at least easy to administer.

330. On the other hand, the popularity of the typical full-deferral estate plan in large part is attributable to the fact that, by preventing the surviving spouse from disposing of QTIP, it allows the testator to control the ultimate disposition of his property. *See supra* text accompanying notes 14-24.

331. *See* I.R.C. § 2044 (1982).

332. *See, e.g.*, Kurtz, *supra* note 8, at 647.

333. *See supra* note 311; *see also* Adams, *Questions and Answers on the Tax Act of 1981*, TR. & EST., Apr. 1982, at 53, 55-56; *id.* Sept. 1982, at 47, 52; *id.* Nov. 1982, at 47, 48; *id.* Dec. 1982, at 53, 55; *id.* Jan. 1983, at 51, 54; *id.* May 1983, at 53, 55. *But see* Gutierrez & Hirsch, *Partial Election for QTIP Treatment*, PROB. & PROP., Fall 1982, at 41 (arguing that "it should be permissible" to make invasions from only the elected part).

334. Temp. Treas. Reg. § 22.2056-1(b), T.D. 7833 (1982), which allows partial QTIP elections, requires that they "relate to a fractional or percentile share of the property so that the elective part will reflect its proportionate share of the increment or decline in the whole of the property for purposes of applying sections 2044 or 2519." Allowing withdrawals or invasions to come from the elected part would defeat the Treasury's effort to ensure that all subsequent changes in value are reflected in the ultimately taxable amount in the same proportion as the election. *But see* Gutierrez & Hirsch, *supra* note 333, at 41 ("It seems unlikely that the IRS intended such a literal reading of the Temporary Regulation."); Joint Report, *supra* note 8, at 8 ("One can only hope that the language of the temporary regulations is inadvertent and will be corrected . . . .").

pal withdrawn during the surviving spouse's lifetime will deplete pro rata not only that portion of the QTIP that will be taxed at the death of the surviving spouse, but also that portion free from taxation.[335] Thus, estate planning by QTIP election eliminates the opportunity to deplete the surviving spouse's estate by the full amount of any principal that she spends.

VI. An Alternative to Reliance on the QTIP Election to Plan the Estates of the Dead

One of the major problems with relying on the QTIP election for postmortem flexibility is that fiduciary duties may make exercise of that election impracticable.[336] Directing the executor by will to make the QTIP election either in whole or part neatly avoids the problem;[337] it frees the fiduciary from liability for making the decision whether to elect QTIP status.[338] It also ties the executor's hands, however, on the basis of information that may be inaccurate at the time of the election.[339] Planning for one or more disclaimers[340] by the surviving spouse,[341] however, makes direction of the executor a viable and

335. Could this problem be solved by creating multiple QTIP trusts, some of which have withdrawal or invasion features and some of which do not? If the executor determined that a partial election was appropriate, he presumably would elect full QTIP status with respect to the QTIP trusts that had withdrawal or invasion features and fail to make the election with respect to the other QTIP trusts. *See* Gutierrez, *supra* note 8, ¶ 1404.1(B). Temp. Treas. Reg. § 22.2056-1(b), T.D. 7833 (1982) does not address the issue. *See* McCaffrey & Kalik, *supra* note 8, at 2, col 5.

336. *See supra* notes 144-293 and accompanying text.

337. *See, e.g.*, J. Price, *supra* note 6, at 259; Adams, Sweet & Herpe, *supra* note 44, at 29; Brackney, *supra* note 8, at 29; Gamble, *supra* note 52, at 44, 47; Kurtz, *supra* note 8, at 643; Ledwith, *supra* note 199, at 25; Moore, *Conflicting Interests*, *supra* note 6, ¶ 603.4; Moore, *New Marital Deduction*, *supra* note 6, ¶ 904; Strauss, *supra* note 6, at 77. Joint Report, *supra* note 8, at 13, however, states that "[t]he testator would not be well advised to tie the executor's hands concerning the election . . . ." Besides the lock-in effect of a directed election, the only reason provided for the Joint Report's conclusion is that "section 2056(b)(7)(B)(v) vests the discretion to make or forego the election squarely in the executor, and it is subject to question whether a testator can remove such power from an executor's control." *Id.* at 14. The author does not share the view that the possibility of a directed election is questionable. Joint Committee, *supra* note 327, at 235, states that the QTIP election "can be made by the executor whether or not the decedent's will instructs the executor to make the election."

338. *Cf.* Note, *supra* note 298 (arguing that courts generally should enforce exculpatory language where trustees have been directed to follow others' investment advice).

339. *See* Moore, *New Marital Deduction*, *supra* note 6, ¶ 904; Moore, *Conflicting Interests*, *supra* note 6, ¶ 603.4.

Some commentators have offered the suggestion that the executor be directed by will to follow a third party's instructions as to the exercise of the QTIP election. *See, e.g.*, Adams, Sweet & Herpe, *supra* note 44, at 29; Gutierrez, *supra* note 8, ¶ 1401.1; Kurtz, *supra* note 8, at 644; Moore, *New Marital Deduction*, *supra* note 6, ¶ 904. *But cf.* Moore, *Conflicting Interests*, *supra* note 6, ¶ 603.3 (arguing that person directing executor's election also would be subject to fiduciary obligations).

340. *See generally* Frimmer, *Disclaimers After the Tax Reform Act of 1976: Chaos out of Disorder*, 31 Major Tax Plan. 811 (1979) (including analysis of the disclaimer cases and statutes of numerous states); Frimmer, *The Federal Disclaimer Rules—E Pluribus Unum?*, 14 Inst. on Est. Plan. ¶ 400 (1980) (same); Martin, *supra* note 145; Melvoin, *Disclaimers: The Time Is Ripe, But Is It Reasonable?*, 16 Inst. on Est. Plan. ¶ 400 (1982); Wenig, *Recent Developments in Estate and Gift Taxes: Disclaimer—The Proposed Regulations*, 15 Real Prop., Prob. & Tr. J. 743 (1980).

341. *See, e.g.*, Gutierrez, *supra* note 8, ¶¶ 1402, 1403.1, 1403.3.

I.R.C. § 2518(b)(4)(A) (1982) provides that the fact that a disclaimed interest "passes" to the surviving spouse does not disqualify the disclaimer. For example, Prop. Treas. Reg. § 25.2518-

attractive alternative.[342] The right of a beneficiary to disclaim his interest apparently is not saddled by fiduciary obligations.[343] Moreover, the surviving spouse usually is the testator's primary beneficiary and most trusted confidant. Therefore, the testator can leave the decision as to how much marital deduction is desirable in the hands of the surviving spouse. Additionally, this placement also is appropriate from the surviving spouse's point of view, because the surviving spouse's financial stake in the decedent's estate is linked directly to the amount of the marital deduction.

Disclaimer planning can assume an infinite variety of forms. The simplest is no planning. A disclaimer by a surviving spouse of a QTIP income interest should bar the marital deduction, even if the executor has elected QTIP status.[344] This possibility, however, makes a disclaimer a very expensive proposition for the surviving spouse, who thereby loses her entire interest in the trust. Moreover, the typical surviving spouse's intense fear of exhausting available assets can make parting with any significant amount of property difficult. Additionally, a disclaimer may accelerate remainders to individuals who are not deemed old enough to manage the property properly. Finally, for emotional reasons, the surviving spouse may be unwilling to disclaim property that her dearly departed mate left to her. For all these reasons, reliance on disclaimers to fine-tune the estate plan may at first seem misplaced.

Careful planning and drafting, however, can increase the odds of a disclaimer. First, the disclaimer can be made much less expensive. Drafting to cause any disclaimed trust property to pass to another trust in which the surviving spouse has a similar interest is one means to that end.[345] The credit-

2(e)(2) & (5) ex. 4 (1980) allows a surviving spouse to disclaim although obtaining an almost identical interest as a result of the disclaimer.

. Disclaimer planning as a means of tailoring the marital deduction predates ERTA. *See, e.g.*, Lewis, *Uncertainty in Disclaimer Laws Creates Problems for Estate Planners*, 34 OKLA. L. REV. 419, 464-69 (1981); Moore, *Drafting in Contemplation of Disclaimer*, 11 INST. ON EST. PLAN. ¶¶ 900, 903.5 (1977).

342. *See* Blazek & O'Donoghue, *supra* note 3, ¶ 7.05[4][b]; Carpenter & Hanna, *Disclaimers: A Pre-Mortem Estate Planning Tool*, TR. & EST., Aug. 1982, at 47, 48, 50; Moore, *New Marital Deduction*, *supra* note 6, ¶ 906. But see Joint Report, *supra* note 8, at 18, which counsels that,

> the estate planner should not rely solely on the use of disclaimers to implement the estate plan. It would be prudent, instead, to deal directly with the problems of the election and allow the estate plan to function without the necessity of utilizing disclaimers. Then the added flexibility permitted under the disclaimer laws would further enhance the options available in connection with the testator's estate.

343. *See* Joint Report, *supra* note 8, at 17. Later, the executor of the surviving spouse's estate may have an almost incurable fiduciary problem if asked to disclaim when the beneficiaries of the spouses' estates differ. *See* Dobris, *supra* note 3, at 829 n.242; Ketchum & Johnson, *supra* note 8, at 93; Stewart, *supra* note 10, at 28. Even if the estates' beneficiaries are the same, the executor's authority to disclaim may be questionable. *See* Frimmer, *Disclaimers After the Tax Reform Act of 1976: Chaos out of Disorder*, *supra* note 340, at 868-69 nn.173-74; Stewart, *supra* note 10, at 28; UNIFORM PROBATE CODE § 2-801(a) (West 1982) (authorizing disclaimers on behalf of the incapacitated but not the dead).

344. The IRS already has so ruled. Rev. Rul. 83-26, 1983-1 C.B. 234. Why did this fact pattern develop? Was the executor unwilling to elect other than full deferral because of fiduciary restraints?

345. Drafting for a disclaimer by the surviving spouse ensures that if a disclaimer occurs the property in which the disclaimed income interest existed will not pass simply as though the surviving spouse had predeceased the first spouse to die, as otherwise would occur under state law. For

shelter trust is the simplest choice for a disclaimer receptacle. Although this trust will not be included in the surviving spouse's gross estate, she usually will have at least a discretionary income interest in the trust. In other instances, however, a separate disclaimer trust may be more appropriate.[346] The surviving spouse's interests in the disclaimer receptacle could include the right to receive all of the income[347] and the right to receive discretionary principal payments.[348] Thus, the financial disincentive to disclaim would be limited to the decreased income flow resulting from the prepayment of the estate taxes, and the surviving spouse's fear of exhausting her assets thus would be placated. This plan also would prevent the trust property from reaching the QTIP remaindermen prematurely. The impulse to keep what the decedent "left to me" should be decreased by the presence in the dispositive document of an elaborate disclaimer mechanism. Strong precatory language is an additional method of notifying the survivor that the testator intends to leave to the survivor not only the right to receive the QTIP income but also the burden of deciding how much marital deduction is appropriate.[349] Inclusion of both spouses in planning conferences that include candid discussions of disclaimer planning helps educate the survivor about the need to evaluate seriously the possibility of disclaimers.[350] Each of these suggestions increases the viability of spousal disclaimers as a means of fine-tuning a full-deferral estate plan.

Disclaimer planning can avoid all the potential tax problems discussed.[351] In providing for the disposition of disclaimed property, the testator can permit a spreading of the income tax burden. If the surviving spouse remains the sole income beneficiary of the disclaimer trust, she will continue to be taxed on all

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a survey of state disclaimer laws, see Note, *Federal Taxation: Section 2518 Disclaimers—Anything But Uniform*, 31 U. FLA. L. REV. 188 (1978). Instead, disclaimer drafting requires that trust principal subject to a disclaimer pass to a disclaimer trust. *See* Blattmachr & Lustgarten, *Selected Considerations*, *supra* note 3, at 39.

346. *See, e.g.*, Katz & Blessing, *Marital Deduction Estate Planning After the Economic Recovery Tax Act of 1981*, 37 J. OF MO. B. 503, 508 (1981). Restrictions imposed by Proposed Treas. Reg. § 25.2518-2(e)(2) (1980) may make disclaimer into the credit-shelter trust inappropriate. For example, Proposed Treas. Reg. § 25.2518-2(e)(5) (1980) denies a qualified disclaimer if the disclaimant retains a special power of appointment over the disclaimed property. Such a power is common in credit-shelter trusts. Retention of a right of withdrawal—a five and five power—similarly may disqualify the disclaimer. *See, e.g.*, Covey, *Recent Developments Concerning Estate, Gift and Income Taxation—1980*, 15 INST. ON EST. PLAN. ¶¶ 100, 136.2 (1981); Mulligan, *supra* note 52, at 10-11. *But see* Wenig, *supra* note 340, at 772-73. Even a power over beneficial enjoyment exercisable by the surviving spouse as trustee of the disclaimer trust would prevent a qualified disclaimer. *See* Proposed Treas. Reg. § 25.2518-2(d)(1)(ii) (1980).

347. In addition to encouraging the surviving spouse to disclaim, an all-income-to-the-surviving-spouse disclaimer trust serves another important function if the decision to prepay any estate tax is made. Such a trust would qualify, in the surviving spouse's estate, for the credit for property previously taxed under I.R.C. § 2013 (1982). *See* Treas. Reg. § 20.2013-5(a) (1973); Rev. Rul. 59-9, 1959-1 C.B. 232; Moore, *New Marital Deduction*, *supra* note 6, ¶ 906.

If the surviving spouse is to be entitled to all of the trust income, a potential QTIP trust may exist. If so, the executor should be directed not to elect QTIP status for the disclaimer trust.

348. *See* Proposed Treas. Reg. § 25.2518-2(e)(5) ex. 6 (1980).

349. *See* Stewart, *supra* note 10, at 28.

350. Such inclusion would ease greatly the surviving spouse's lack of knowledge. This lack of knowledge is cited by Carpenter & Hanna, *supra* note 342, at 50, as an important reason why the disclaimer can appear to the surviving spouse as a " 'no-win' situation."

351. *See supra* notes 309-35 and accompanying text.

of the income.[352] If the trustee is authorized to accumulate income or to distribute income among other beneficiaries, however, the surviving spouse will be taxed only on her share of the disclaimer trust's distributable net income.[353] Thus, disclaimer planning has the potential to avoid wasteful income taxation during the life of the surviving spouse.

Disclaimer planning also completely avoids both of the gift tax problems discussed above.[354] Qualified disclaimers generate no gift tax when made. In addition, since section 2519 applies only to QTIP interests, a taxable transfer by the surviving spouse of her income interest in a disclaimer trust does not constitute a taxable gift of the disclaimer trust remainder.

Finally, in planning for disclaimers the testator can provide that disclaimed property passes to a disclaimer trust in which no withdrawals or invasions are possible until the principal of the QTIP is exhausted. With this provision, any depletion during the surviving spouse's lifetime would reduce the estate taxes due at her death.

The testator contemplating disclaimer planning, however, must keep in mind the possibility that the spousal disclaimer never may be used.[355] Indeed, one of the principal reasons for placing the ultimate decision in the hands of the surviving spouse, rather than those of an executor, is that she is the testator's overwhelmingly predominant beneficiary. Consequently, the testator should be satisfied with any decision his surviving spouse makes. If this is not the case, disclaimer planning must not be relied on to fine-tune a full-deferral estate plan.[356]

VII. CONCLUSION

Because full deferral deliberately foregoes the opportunity to utilize the lowest estate tax brackets available to the estate of the first spouse to die, it can deplete the family wealth that remains after the death of the surviving spouse. If the spouses' combined taxable wealth increases after the death of the first spouse to die, full deferral can cause an especially severe depletion because it also deliberately foregoes the opportunity to "freeze" the surviving spouse's estate. But since prepayment of estate tax accelerates a tax that is not due and thereby deprives the surviving spouse of income and access to principal, the vast majority of clients nevertheless opt for full deferral as a primary estate plan. Those who are advised that full deferral can be very costly to their ulti-

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352. *See* I.R.C. § 652 (1982).

353. *See id.* § 662. Distributable net income is defined in *id.* § 643(a).

354. *See supra* notes 315-30 and accompanying text.

355. One reason, in addition to those mentioned in the text, why the disclaimer never may be used is that the surviving spouse may be incompetent at or shortly after the death of the first spouse to die. In such a situation, almost irresolvable conflicts might arise, and the authority of the surviving spouse's legal representative to disclaim might be put into issue, as in the case of the deceased surviving spouse. *See supra* note 343. The surviving spouse's legal representative obviously would be concerned primarily with providing fully for the possibly huge but potentially short-lived needs of his ward.

356. One situation in which spousal disclaimers should not be relied on is that involving a second (or later) marriage if there are children by a prior marriage. *See generally supra* note 21.

mate beneficiaries nevertheless may choose full deferral because they also are advised that their executors will decide whether prepayment of the tax is appropriate by electing or failing to elect QTIP status.

Examination of the questions implicit in the considerations relevant to making the QTIP election, however, reveals that the great majority of those questions properly can be answered only by the testator. Even if the questions involved administrative rather than dispositive issues, the QTIP election would raise difficult issues of fiduciary conduct. Many of the questions, however, require dispositive answers.

An executor who causes an estate to prepay the estate tax, even in a good-faith effort to optimize the QTIP remainder, probably breaches the fiduciary duty to minimize taxes. The fiduciary also will worry whether he has failed to treat the estate's beneficiaries impartially. On the other hand, a surviving spouse or QTIP remainderman acting as executor may hesitate to exercise the QTIP election for fear that she might breach the fiduciary duty of loyalty by favoring herself. Even if the duty to minimize taxes, the duty to treat beneficiaries impartially, and the duty of loyalty are remitted expressly by the testator, tax-generating partial QTIP elections still will be extraordinarily rare.[357] Therefore, reliance on fiduciary exercise of the QTIP election is likely to fail miserably as an option for achieving post-mortem flexibility. Moreover, reliance on fiduciary exercise of the QTIP election creates income, gift, and estate tax problems that may offset substantially the supposed advantage gained by the theoretical possibility of a partial QTIP election.

An attractive alternative is to direct the executor to make the QTIP election, while providing for disclaimers by the surviving spouse. But because surviving spouses often are unwilling to disclaim property recently left them by their spouses, such a route must be undertaken only when the surviving spouse is the client's overwhelmingly predominant beneficiary or when the client implicitly trusts the surviving spouse with the responsibility of deciding how much marital deduction is appropriate.

The ultimate failure of both fiduciary exercise of the QTIP election and spousal disclaimers to provide post-mortem flexibility derives from the fact that only the testator can determine how much marital deduction is appropriate. The answer necessarily must be a bit of a guess in some cases, and if the testator could make the decision after his death, the answer might be somewhat better. An executor, however, is incapable of answering whether the surviving spouse is the overwhelmingly predominant beneficiary and whether the family business eventually should pass intact to the children. Thus, it is hardly surprising that the executor saddled with such a burden would take the easy way out by electing full deferral and thereby minimize present taxes in favor

357. "Trust legal counsel will have to carefully analyze the will or trust that is designed to take advantage of the qualified terminable interest property deduction to ascertain whether it contains sufficient safeguards for the professional fiduciary in exercising that election." Ritchie, *supra* note 146, at 38. *See also* Gutierrez, *supra* note 8, ¶ 1404.1(a) (executors will tend to elect full QTIP to minimize current taxes); *supra* note 235.

of the surviving spouse. Similarly, a surviving spouse, only recently separated from the testator, understandably assumes that no disclaimer is necessary to effectuate the testator's wishes.

Post-mortem estate planning unquestionably serves an important function. It has, however, been performed only haltingly even in the relatively simple administrative context of deciding whether to deduct administration expenses for income or estate tax purposes or to use the alternate valuation election, situations in which comparison of tax brackets or valuations generally answers the question. Expanding post-mortem estate planning to include the decision whether a marital deduction should be claimed requires the executor to decide whether up to one-half of the estate immediately will be conceded to the federal government. This decision is qualitatively different from anything previously described as post-mortem estate planning; it partakes of planning the estates of the dead. As a general rule, the dead should have been required to plan their own estates.